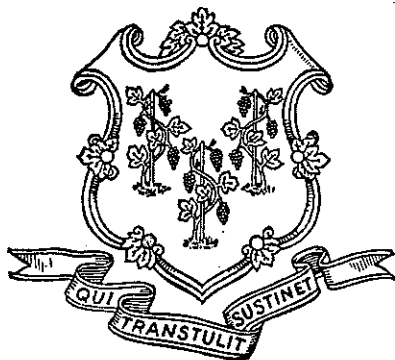


# **Regulation and Operation of Legalized Gaming in Connecticut**

**Connecticut  
General Assembly**



**LEGISLATIVE  
PROGRAM REVIEW  
AND  
INVESTIGATIONS  
COMMITTEE**

**January 1993**

**CONNECTICUT GENERAL ASSEMBLY  
LEGISLATIVE PROGRAM REVIEW AND INVESTIGATIONS COMMITTEE**

The Legislative Program Review and Investigations Committee is a joint, bipartisan, statutory committee of the Connecticut General Assembly. It was established in 1972 to evaluate the efficiency, effectiveness, and statutory compliance of selected state agencies and programs, recommending remedies where needed. In 1975, the General Assembly expanded the committee's function to include investigations, and during the 1977 session added responsibility for "sunset" (automatic program termination) performance reviews. The committee was given authority to raise and report bills in 1985.

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# **THE REGULATION AND OPERATION OF LEGALIZED GAMING IN CONNECTICUT**

**LEGISLATIVE PROGRAM REVIEW AND INVESTIGATIONS COMMITTEE  
JANUARY 1993**

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## TABLE OF CONTENTS

EXECUTIVE SUMMARY .....	i
INTRODUCTION .....	1
I. LEGALIZED GAMBLING TRENDS .....	3
Trends in Connecticut .....	5
Sales and Revenue Trends .....	7
II. REGULATION AND OPERATION OF GAMBLING IN CONNECTICUT .....	13
Gaming Policy Board and Division of Special Revenue .....	13
Division Operations .....	17
Lottery .....	17
Gambling Regulation and Operations .....	19
Parimutuel Regulation .....	19
Charitable Games .....	20
Off-Track Betting .....	20
Management Services and Administrative Support .....	23
Overview of Operating Expenses .....	23
III. FINDINGS AND RECOMMENDATIONS .....	27
Separating Regulatory Functions and Operations .....	27
Agency Restructuring .....	30
Licensing Process .....	33
Off-Track Betting Operations .....	37
Lottery Operations .....	42
Problem Gambling .....	48
APPENDICES	
A. Legalized Gaming By State .....	A-1
B. Agency Response .....	B-1

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## EXECUTIVE SUMMARY

The Legislative Program Review and Investigations Committee authorized a study of the operation and regulation of legal gaming, as carried out by the Division of Special Revenue, in February 1992. The committee focused on evaluating how the division meets its goal to maximize revenues while insuring integrity and security of legalized gaming in Connecticut. Early in the study, the inherent conflict between the division's role as both promoter and regulator of gambling was identified as a key issue. A primary goal was to determine ways to create a strong regulatory agency, capable of assuring gaming integrity and protecting the public interest regardless of the scope of legal gambling in the state.

Initial interest in the topic stemmed from concern over the direction taken by the division regarding off-track betting (OTB). Rather than pursuing privatization as recommended by various consultants, the agency seemed to be moving toward more direct involvement in operating the OTB system. At the same time, broad questions about the division's regulatory performance were being raised as the legislature considered authorizing new forms of gambling in Connecticut.

Legalized gaming in Connecticut is an uncommon mix of publicly regulated private businesses, publicly operated gaming activities, and the collection of gaming revenues, all handled within a single state agency. While significant legal gambling operations are provided by private businesses, the state also runs sizable gaming concerns by way of the lottery and off-track betting. The Division of Special Revenue is unique among state agencies in that it performs three major functions: first, it collects taxes on certain businesses that are licensed by the agency; second, it regulates legalized gambling operations through licensing and continual oversight to assure integrity of gaming in Connecticut; and third, the agency operates and promotes certain games of chance. These three functions -- *regulating, operating, and taxing* - are generally carried out by separate state agencies. Two functions, operating a business and regulating the same industry, are in direct conflict.

The recommendations presented in the following pages focus on clarifying the state's role in legalized gambling by separating business operations from regulatory functions, and transferring tax collection to the Department of Revenue Services. To achieve this, a major restructuring of the state gaming agency is proposed. The committee believes its recommended policy and structural changes will improve operations as well as strengthen regulatory enforcement. In addition, recommendations are made to address deficiencies in information about and funding for problem gambling prevention, treatment, and rehabilitation programs.

The following recommendations were adopted by the Legislative Program Review and Investigations Committee on December 15, 1992. All recommendations, with the exception of the first -- legislative policy -- require legislation for implementation.

## **RECOMMENDATIONS**

### **LEGISLATIVE POLICY: SEPARATING REGULATORY FUNCTIONS AND OPERATIONS**

**1. Adopt the following as legislative policy:**

**Gambling regulatory functions shall be separated from all gaming operational activities. All gaming operations shall be operated by private business entities, to be regulated by the state, and where there is an overwhelming state interest to operate gaming, shall be operated under the jurisdiction of a quasi-public governmental entity.**

### **AGENCY RESTRUCTURING**

**2. Establish a new Gaming Control Commission that shall consist of three units: 1) gambling regulation; 2) audit; and 3) administration. (See organization chart, Figure 11, on page 31). The purpose of this structure is to strengthen the regulatory process by combining all the licensing and integrity assurance functions in one unit while providing a separate unit to focus on financial audits of gaming operations. The third unit shall be responsible for administering the agency, providing research, and conducting administrative hearings on contested cases.**

**The agency shall be headed by an executive director who shall be appointed by the Gaming Control Commission. The three unit heads shall be part of the state's classified service.**

**The Gaming Policy Board shall be replaced by the Gaming Control Commission and have approval authority over the following areas:**

- ◆ licensing;**
- ◆ contracts;**
- ◆ regulations;**
- ◆ performance dates; and**
- ◆ appeals.**

**The commission shall consist of seven members; three shall be appointed by the governor and four shall be appointed by the leaders of the general assembly. Appointments shall be coterminous with the appointing authority. The governor shall appoint the chairman of the commission.**



The commission shall also be responsible for continuously monitoring the impact gambling has on society in Connecticut and report its findings annually to the governor and the General Assembly.

Questions related to whether or not an entity is operating within statutory authorization shall be investigated by the executive director; the executive director shall determine whether licensees are in compliance with statutes and regulations that define operations. Decisions of the executive director concerning licenses may be appealed to the Gaming Control Commission.

All functions related to collection of gaming tax revenues shall be transferred to the Department of Revenue Services.

#### **STRENGTHEN THE LICENSING PROCESS**

3. The licensing process shall be applied only to those individuals or businesses with direct control over gaming integrity. Current statutes shall be amended to provide for two categories of licenses: 1) Class I and Class II. Class I licenses shall be designated for those who own and/or operate authorized gaming facilities. Class II licenses shall be for employees of a Class I licensee who are players, judges or have substantial control over the operation of a race, performance, or game. All other employees need not be licensed by the Gaming Control Commission. License requirements currently mandated by statute shall continue unchanged.

Class I Licenses shall apply to the following forms of gaming:

- ◆ jai alai;
- ◆ dog racing;
- ◆ horse racing; and
- ◆ off-track betting.

#### **LICENSE OFF-TRACK BETTING**

4. Off-track betting facilities shall be operated as licensed franchise businesses. Statutory restrictions on the type and character of facilities shall be removed and the Gaming Control Commission shall set standards for off-track betting facilities.

**THE CONNECTICUT LOTTERY CORPORATION, INC.**

- 5. All lottery operations shall be transferred to the Connecticut Lottery Corporation, a quasi-public agency based on Connecticut General Statute section 1-120 through 1-125. The Corporation shall be a wholly owned, non-stock, non-appropriated government corporation.**

**The Connecticut Lottery Corporation shall be governed by a board of seven directors. The membership shall include the commissioner of the Department of Revenue Services, the Treasurer of the State of Connecticut or his designee, a member of the Gaming Control Commission appointed by the governor, and four members from the private sector who have knowledge and experience in the fields of business, finance, and marketing, to be appointed by the governor. The terms of the four private sector members shall be coterminous with the governor.**

**There shall be a director of the Connecticut Lottery Corporation appointed by the board of directors who shall report directly to the board.**

**The powers of the Connecticut Lottery Corporation shall be vested in and exercised by a board of directors. The board of directors may delegate to three or more board members, at least one of whom shall be a non-state employee, such powers and duties that the full board of directors may deem proper. The board can create any advisory committee it deems necessary to provide assistance.**

**The Connecticut Lottery Corporation's board of directors shall adopt written procedures for:**

- an annual budget and a plan of operations that, at a minimum, requires the board's approval before they become effective;**
- hiring, dismissing, promoting, and compensating staff, and such procedures and policies shall require board approval before a position can be created or a vacancy filled;**
- acquiring real and personal property and personal services, and such procedures shall, at a minimum, require the board to approve all expenditures in excess of \$5,000;**
- obtaining professional services, such as financial advisors, legal counsel, and auditors, and at a minimum such procedures shall require the corporation to solicit proposals at least every three years for each service it uses; and**
- using surplus funds.**

**The purpose of the Connecticut Lottery Corporation shall be to conduct and administer lottery games that will result in the maximization of revenues to the State of Connecticut while at the same time provide entertainment to the citizens. The corporation's duty will be to provide for the effective operation of lottery games, which insures the integrity of the lottery and maintains the dignity of the state and the general welfare of its citizens. To carry out its statutory authority and obligations, the corporation shall have the power:**

- **to adopt an official seal;**
- **to sue and be sued, plead and be impleaded;**
- **to charge and collect fees for its services and products;**
- **to receive and accept aid or contributions including money, property, labor, and other things of value from any source;**
- **to conduct quarterly progress reviews;**
- **to develop a standard policy and procedures manual;**
- **to review and reconfirm purchasing practices;**
- **to make and enter into all contracts and agreements necessary or incidental to the performance of its duties and execution of its powers under its enabling legislation -- including such professional services as financial consultants and technical specialists as the board deems necessary;**
- **to invest any funds not needed for immediate use or disbursement -- including reserve funds -- in obligations issued or guaranteed by the United States of America or State of Connecticut and in other obligations which are legal investments for savings banks in this state;**
- **to employ such staff as it deems necessary and fix their qualifications, duties, and compensation;**
- **to borrow money to the extent permitted by statute;**
- **to procure insurance against any loss in connection with its property and other assets in such amounts and from such insurers as it deems desirable;**

- to account for and audit funds of the corporation; and
- to establish and adopt regular procedures for exercising its power under its enabling legislation not in conflict with existing statutes.

**The Connecticut Lottery Corporation shall be specifically responsible for the operation of lottery games as follows:**

- ◆ the types of games to conducted;
- ◆ the sale price of tickets;
- ◆ the number and amount of prizes;
- ◆ the method and location of validating tickets;
- ◆ the frequency and method of conducting public drawings;
- ◆ the selection of and compensation to lottery retailers; and
- ◆ any other matters necessary or desirable for the efficient and effective operation of the lottery or the convenience of the public.

**All lottery proceeds shall be deposited from a special lottery fund which shall be used to operate the corporation, the lottery games, and provide prizes to winners. Excess funds shall be deposited to the general fund on a quarterly basis.**

**The Connecticut Lottery Corporation will be required, pursuant to Connecticut General Statute section 1-122, to annually contract with any person, firm, or corporation for a compliance audit of its activities for the fiscal year. The audit will determine the corporation's compliance with its regulations concerning affirmative action, personnel practices, the purchase of goods and services, the use of surplus funds, and distribution of loans, grants, and other financial assistance. The board of directors will submit the audit report to the governor, the auditors of public accounts, the Gaming Control Commission, and the joint standing committee of the general assembly having cognizance of matters relating to gaming and revenue.**

**The Gaming Control Commission shall be responsible for insuring the integrity of all lottery games.**

**The auditors of public accounts shall be responsible for auditing the Connecticut Lottery Corporation as required by Section 2-90(c) of the Connecticut General Statutes.**

## **PROBLEM GAMBLING PROGRAMS**

- 6. Existing statutes (C.G.S. section 17a-477, as amended by Public Act 92-216) shall be amended to require that a fee equivalent to .05 percent of handle be applied to all legal gaming operations in the state for the purposes of funding problem gambling programs.**
- 7. The Connecticut Alcohol and Drug Abuse Commission shall be required to report annually to the Gaming Control Commission on the activities of the compulsive gambler treatment program it administers. At a minimum, the commission should receive information on requests for services, number of admissions, client demographics, and source of problem (e.g., uncontrolled behavior related to lottery, racing, casino games, etc.).**

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## INTRODUCTION

In Connecticut, legalized gambling represents a significant business enterprise. In FY 92, games regulated and operated by the state produced over \$731 million in gross revenues. The Division of Special Revenue (DSR), within the Department of Revenue Services for administrative purposes only, is responsible for administering and regulating legal gaming activities in the state. The division is overseen by a five-member, gubernatorially appointed Gaming Policy Board and headed by an executive director, who is a non-voting ex officio member of the board. Gaming programs operated by the division include lottery, off track betting (OTB), jai alai, and dog racing. State law also authorizes, but the division does not operate, horse racing in Connecticut. Since 1987, the division has been responsible for permitting and regulating charitable gaming activities (e.g., bingo, raffles, bazaars, and "Las Vegas Nights").

Major functions of the division include: designing, promoting, and distributing various state lottery games; operating off-track betting facilities; licensing and supervising jai alai and dog track facilities; and developing, implementing, and enforcing regulations, policies, and procedures concerning legal gaming activities. In March 1992, the Legislative Program Review and Investigations Committee authorized a study of the activities carried out by the division.

The study focused on evaluating how the division met its goal to maximize revenues while assuring the integrity and security of the activities it administers and regulates. In reviewing division performance, all aspects of its management and operations were examined. Particular attention was given to determining what, if any, legislative and administrative changes might be needed to improve operating efficiency and regulatory effectiveness under the current or an expanded scope of state legal gaming activities.

The committee report is organized into this introduction and three additional sections. An overview of national trends in legalized gambling and more detailed descriptions of trends in Connecticut, especially in terms of sales and revenues is provided in Chapter I. Chapter II includes descriptions of the organization and operation of the state's legalized gaming activities. Program review committee findings and recommendations concerning the regulation and operation of legalized gambling are presented in Chapter III.

It is the policy of the Legislative Program Review and Investigations Committee to provide agencies subject to study with an opportunity to review and comment on recommendations prior to the publication of a final report. The formal response of the Division of Special Revenue to this report is presented in Appendix B.

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## CHAPTER I LEGALIZED GAMBLING TRENDS

The United States is currently experiencing the greatest wave of legalized gaming in its history. At present, gambling is permitted in some form, at least for charitable fundraising purposes, in all states except Hawaii and Utah. The status of legal gaming in each state as of mid-1992 is summarized in Appendix A. While states vary widely in the scope of gambling they permit, all legal gaming has the same primary purpose--to generate revenues. Another frequently cited goal of state sponsored gaming is to curb illegal gambling activities.

At present, the major components of legal gaming in the U.S. are:

- ◆ lotteries, including lotto, instant, and numbers games;
- ♣ casino games, both table (e.g., poker, blackjack, and roulette) and device (e.g., slot machines);
- ♠ parimutuel wagering<sup>1</sup>, which includes on-track horse and dog racing, off-track betting (OTB), and jai alai; and
- ♥ bingo, raffles, bazaars, and low-stake games of chance like "Las Vegas nights" conducted for charitable purposes.

**Lottery.** Modern lotteries in the United States have developed as state-run monopolies. The first was initiated by New Hampshire in 1964. Lottery games gained considerable social acceptance during the 1970s and 1980s as many states used them to raise revenues and avoid tax increases. By mid-1992, 34 states and the District of Columbia were operating lotteries, most of which include lotto, instant, and numbers games.

State lottery games have been well received by the American public. Over the past decade, total U.S. lottery sales grew at an average annual rate of 25 percent. The sales increase in FY 91, however, was only 2.2 percent, the smallest gain in 20 years. This dramatic change is attributed to customer dissatisfaction with traditional products, a soft economy, and increased competition for bettors' dollars. To improve revenue performance, a few state lotteries (e.g., Montana, South Dakota, West Virginia, and Oregon) have recently expanded into new and

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<sup>1</sup> Under parimutuel systems, bettors wager against each other rather than a bookmaker or against the house as in casino gaming.

controversial areas such as video lottery terminals (VLTs)<sup>2</sup> and sports betting. New products and marketing techniques are being seriously studied in a number of lottery states.

**Casino.** Casino style gaming, which is quickly growing in availability in the U.S., is a primary source of competition for lotteries. For years, casino gambling was legal only in Nevada. In 1978 the first casino opened in Atlantic City, New Jersey, but no further expansion occurred until the late 1980s. At that time, several western (Colorado, South Dakota) and Mississippi river states (Iowa, Illinois, Mississippi) legalized casino style gaming in hopes of boosting selected local economies. In addition, federal legislation enacted in 1988 made it possible for Indian tribes in many states to open casinos and otherwise expand their commercial gaming operations. Legalization of some form of casino gambling is under consideration in a number of states at the present time. Gaming experts predict that the 1990s will see the advance of casinos across the U.S.

**Parimutuel.** Competition from the explosion of state lotteries and spread of casino gaming has contributed to a general decline in racing and other parimutuel sports over the past decade. After years of being "the only game in town," the parimutuels are now considered the industry's weakest segment. Horse racing, however, remains the most prevalent form of state legalized gaming. Authorized in some form in 43 states (e.g., thoroughbred, quarter, or harness), horse racing was conducted at tracks in 36 states during 1992.

Other forms of legal parimutuel gaming are less widespread. In 1991, greyhound racing, which was newly authorized in Texas and Wisconsin, was held at 59 tracks in 18 states. It is also authorized but not operated in Nevada. Off-track betting, long opposed by many in the racing industry, has now been legalized in 15 states. Most OTB states (12) permit teletheater (simulcasting) facilities as well the more traditional betting "parlors". The least common type of U.S. parimutuel gaming is jai alai, a form of handball that originated in the Basque region of Spain. First operated in Florida in the 1920s, jai alai is now legal in four states but only operates in three.

**Charitable.** Although little reliable information on revenue trends has been collected on a nationwide basis, it is believed that U.S. charitable gaming is growing each year both in size and scope. Nearly every state permits bingo for charity and in a few, it is the only form of legal gaming. More typically, charitable gaming at the state level also includes raffles, bazaars, sealed tickets or pull tabs (similar to instant lottery tickets) and may encompass casino style games like roulette and blackjack. For the most part, states tend to loosely regulate charitable gambling, despite the often substantial sums that are wagered. According to recent estimates for calendar 1990, total charitable gaming revenues in the U.S. exceeded \$6 billion. It has been suggested by academics who study commercial gambling that as states realize the significance of charitable gaming, there will be stricter regulation and enforcement in the 1990s.

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<sup>2</sup> Video lottery terminals are electronic gaming devices that can be programmed to provide facsimiles of keno, poker, blackjack, and other card games as well as slot machine type games.

## TRENDS IN CONNECTICUT

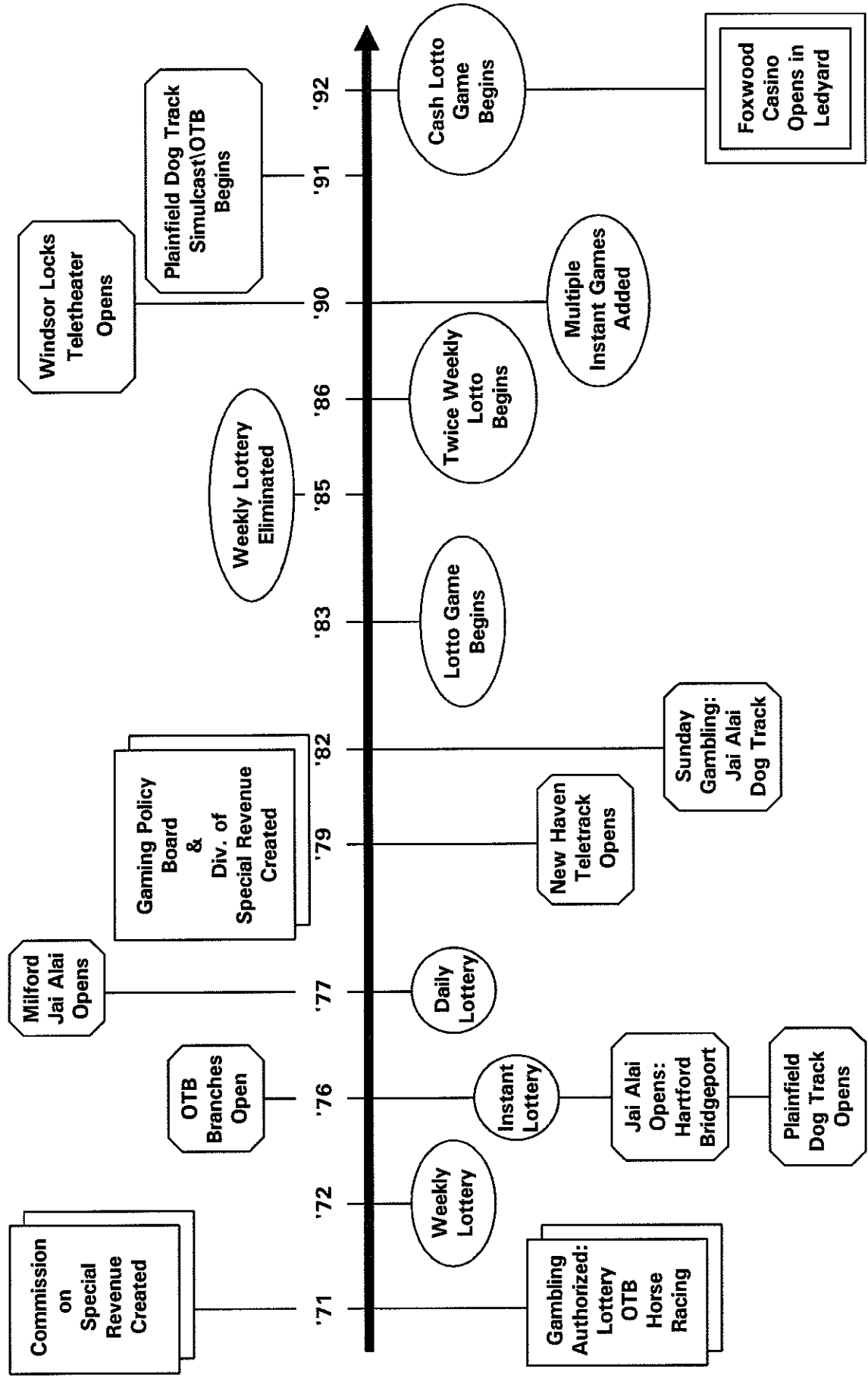
Connecticut entered the legalized gaming market early and fully as Figure 1 illustrates. The figure highlights the development of legal gambling in the state, from 1972 when only a weekly lottery existed to the present. One of the first lottery states, Connecticut was also the second state to legalize off-track betting and the first in the nation to establish an OTB teletheater. Connecticut law permits horse racing, dog racing, and jai alai, although only the latter two parimutuel sports have operated in the state. In fact, Connecticut is the only state without its own horse racing that operates an OTB system. Charitable gaming authorized in Connecticut has grown over the years to include sealed tickets and Las Vegas nights as well as the standard bingo games, bazaars, and raffles.

Casinos and casino-style games along with video lottery terminals, despite recent legislative initiatives, have failed to be added to the state's portfolio of gaming products. However, a casino operated by the Mashantucket Pequot Indian tribe (Foxwoods) opened in Ledyard, Connecticut, in February 1992. The Foxwoods casino has been highly successful and now is being expanded.

In Connecticut, unlike most states, responsibility for legalized gaming has always been centralized in one agency. In contrast, other states have separate boards, commissions, or agencies that oversee different types of gaming (e.g., racing boards and lottery commissions). In 1971, the state's original gaming law (P.A. 71-865) established a nine-member special revenue commission to operate and regulate the state's newly authorized state gambling enterprises (lottery, horse racing, and off-track betting) in accordance with Public Act 71-865. The commission was subsequently abolished and replaced, in 1979, with the present structure--the Division of Special Revenue (DSR) and its oversight body, the five-member Gaming Policy Board (P.A. 79-404). The special revenue agency's jurisdiction over all state legalized gambling became complete in 1987 with the transfer of regulatory responsibility for bingo and other charitable games from the state public safety department to the division.

The Division of Special Revenue also carries out the state's limited regulatory role regarding Indian gaming in Connecticut. The division's functions, negotiated as part of the overall agreement contained in a tribal-state compact finalized in 1991, include licensing casino employees and receiving certain annual financial information. Until June 1992, division staff were also assigned to oversee operations at the Foxwoods casino. Administrative expenses associated with regulating the casino are reimbursed by the Mashantucket Pequot tribe but the state receives no share of revenues from casino operations.

**Figure 1. Major Events in Legalized Gaming In Connecticut**



## SALES AND REVENUE TRENDS

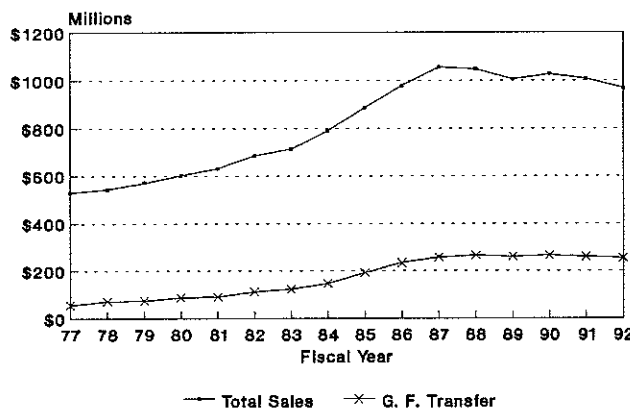
Legal gaming is a significant industry in Connecticut. In FY 91, according to estimates from a recent consultant report, state legalized gambling generated over \$1 billion in wagering, almost \$215 million in revenues to state and local governments, approximately \$148 million in the purchases of goods and services, and over 2,500 full-time equivalent jobs.<sup>3</sup> Based on current (FY 92) data, gross revenues from legal wagering including charitable games represent about one percent of personal income in Connecticut.

Handle, or amount wagered, from the state's lottery games, OTB, and parimutuel facilities (jai alai frontons and dog track) reached just over \$1 billion in FY 87 after growing steadily through the 1970s and early 1980s. Total amount wagered has remained relatively steady. The trend in Connecticut's legal gaming handle in terms of total sales figures for each fiscal year since FY 77 is pictured in Figure 2.

Sales from charitable bingo, raffles, sealed tickets, and games of chance regulated by the state are not included in the totals shown in Figure 2. Long-term data on charitable game handle are not readily available but gross revenue figures for the past four fiscal years show substantial activity and growth. Charitable game sales, which were \$46.7 million in FY 89, have increased each year and totaled \$58 million in FY 92.

Trends in handle, adjusted for inflation, are presented for each major state gaming program in Figure 3. In constant dollars, total sales and sales of each program have steadily declined since peaking in FY 87. OTB, always the smallest contributor to total sales, has experienced the greatest drop in handle of the three programs. Between FY 91 and FY 92, OTB sales adjusted for inflation decreased nearly 20 percent, compared to about a 9 percent and 0.5 percent drop for parimutuel and lottery handle, respectively.

Figure 2. Connecticut Legal Gaming Sales & General Fund Transfer: FY 77 - FY 92



Source of Data: DSR Administrative Reports

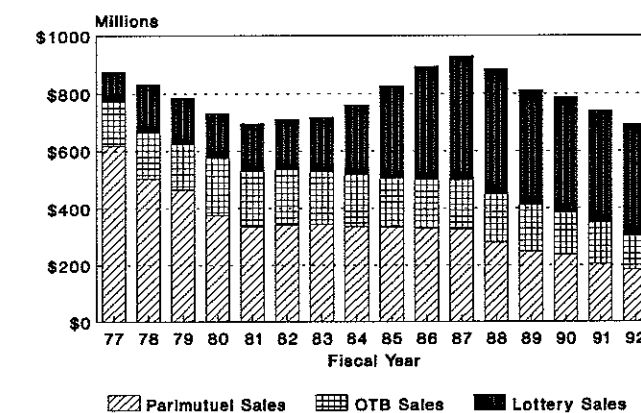
<sup>3</sup> Christiansen/Cummings Associates, Inc., *Legal Gambling in Connecticut: Assessment of Current Status and Options for the Future*, January 1992.

Figure 3 also reflects the expanded lottery activity and contraction of parimutuel betting that has been experienced nationwide. During the period shown in the figure, Connecticut's parimutuel and lottery programs have essentially reversed roles in terms of their contributions to total sales.

Revenue to the state generated by legal gaming has, as expected, tracked trends in handle. Revenue information in terms of gaming monies transferred to the General Fund is pictured with the long-term sales data in Figure 2. Since FY 87, General Fund transfers have averaged about \$260 million per year or approximately 25 percent of total handle.

General Fund transfer are only a partial indicator of state gaming revenue trends. Transferred funds essentially are: 1) betting taxes paid by the operators of licensed parimutuel facilities (jai alai frontons and racetracks); and 2) the handle from lottery and OTB operations minus payment of prizes and most major direct expenses (e.g., compensation paid to lottery agents, fees paid to the racing industry for OTB programs, and statutory payments to municipalities that host gaming facilities). Personnel and overhead costs of the Division of Special Revenue as well as certain operating expenses budgeted through the appropriations process (e.g., costs of lottery advertising and the on-line lottery computer system) are not accounted for in General Fund transfer figures.

Figure 3. Connecticut Legal Gaming Sales  
(Adjusted for Inflation: '82-'84=100)



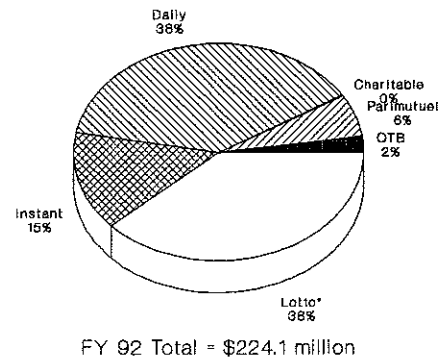
Sources of Data: DSR Administrative Reports/U.S. Bureau of Labor Statistics

Net profit figures that account for all expenses except payroll taxes and fringe benefit costs for each gaming program and in total for fiscal years 1988 through 1992 are presented in Table 1. Payroll taxes and fringe benefit costs for all state employees are paid from a comptroller account, not agency budgets.

Total net profits to the state from legalized gaming, including charitable games, have fluctuated between \$214 million and \$233 million during the five-year period shown in the table. Recent trends in total profits mirror lottery activity, as the three games--daily, instant, and lotto--are by far the largest contributors to legal gambling revenues. Based on the most recent data available, pictured in Figure 4, lottery games are responsible for 92 percent of the state's net profits for legal gaming.

Connecticut's recent net profit data illustrate a situation common to many states with a similar mix of legal gaming. While the net profits of lottery games are generally up, OTB, jai alai, and dog racing annual revenues have steadily declined. Much of the profit loss in the OTB and parimutuel area is related to lower handle (less betting revenues). However, the dramatic drop in OTB net profit between FY 90 and FY 91 is due primarily to the program's unusually high expenses that fiscal year. These included: 1) nearly \$3 million in one-time capital costs related to renovating two OTB parlors and setting up the new teletheater facility in Windsor Locks; and 2) significantly higher fees for computerized betting system services provided by the vendor during 1990.

Figure 4. Legalized Gaming Net Profit by Source: FY 92



Source of Data: DSR Statement of Operations, FY 92  
 \*Lotto includes cash lotto game

Table 1. Net Profit By Source: FY 88 - 92.\* (Dollars in Millions)

	FY 88	FY 89	FY 90	FY 91	FY 92	Change 88-92
<b>Lotto</b>	\$104.7 (+8%)	\$95.8 (-8%)	\$90.4 (-6%)	\$81.2 (-10%)	\$84.7 (+4%)	-19%
<b>Cash Lotto**</b>	N/A	N/A	N/A	N/A	\$1.0 N/A	N/A
<b>Instant Lottery</b>	\$23.5 (-7%)	\$21.3 (-10%)	\$30.0 (+41%)	\$39.7 (+32%)	\$33.0 (-17%)	+41%
<b>Daily Lottery</b>	\$66.8 (+7%)	\$76.2 (+14%)	\$87.2 (+14%)	\$76.9 (-12%)	\$85.7 (+12%)	+28%
<b>OTB</b>	\$10.6 (-3%)	\$10.2 (-4%)	\$8.7 (-14%)	\$1.5 (-83%)	\$5.4 (+254%)	-49%
<b>Jai Alai/ Dog Racing</b>	\$18.8 (-17%)	\$17.2 (8%)	\$16.9 (-2%)	\$14.8 (-12%)	\$13.9 (-6%)	-26%
<b>Charitable</b>	(.02)	\$0.2	\$0.5	\$0.2	\$0.4	N/A
<b>TOTAL</b>	\$224.1 (+3%)	\$220.8 (-1%)	\$233.8 (+6%)	\$214.4 (-8%)	\$224.1 (+4%)	0%

\* Number in parentheses is percentage change over prior year.

\*\* Cash Lotto game initiated in April 1992.

Source of Data: Division of Special Revenue Statements of Operation, Fiscal Years 87-92.

**Consultant report.** Concern over the sales and revenue trends highlighted above led the division in 1991 to commission a consulting firm, Christiansen/Cummings Associates, Inc. (CCA), to, among other tasks, assess the current state of Connecticut's legal gambling and identify and evaluate new gambling options.<sup>4</sup> The \$250,000 study resulted in a six-volume report that was released in January 1992. Key findings and recommendations from the Christiansen/Cummings study are highlighted below.

The CCA study found that Connecticut's legal games are mature products, evidenced by stagnant lottery sales and declining parimutuel revenues. The consultant predicted continued weak performance, which combined with competition from the Foxwoods casino and anticipated new products in surrounding states (e.g., video slot machines in Rhode Island), will further erode state revenues. Increasing deficits were also projected for the licensed operators of parimutuel facilities and for state-operated off-track betting.

Based on its bleak findings, CCA believed Connecticut must consider new gambling options to revive gaming revenue for the future. Recommended actions included:

- 1) Enhance lottery with more frequent instant game turnover, the addition of a cash lotto game (which the division did in April 1992), better automated systems, an agent incentive program, new fees for agents, and an increased advertising budget.
- 2) Permit gaming devices at parimutuel facilities and consider the possibility of allowing video lottery terminals in other locations as well.
- 3) To bring OTB back into the black, convert existing branches into "mini" teletheaters, add two more small simulcast facilities, and permit simulcasting at all parimutuel facilities.
- 4) Pursue current division research into alternative models for OTB operations, particularly privatization options that CCA strongly endorses.
- 5) Consider authorizing casino gaming, provided efforts start slowly, giving high priority to long term financial stability, and including careful evaluation of the impact on existing gambling operations.

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<sup>4</sup> By law, studies of the effect of legalized gaming on Connecticut citizens that include, at a minimum, the types of gaming the public engages in and the desirability of expanding, maintaining, or reducing the amount of legalized gambling allowed, must be conducted by the agency's executive director at least once every five years.



In addition to evaluating and recommending gaming options, the CCA report presented arguments for changing the organizational structure of lottery. Complete separation of lottery operations from other division functions was strongly supported. The report also included an analysis of problem gambling in the state and recommended increased prevention and treatment efforts as well as better funding mechanisms for such services.

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## **CHAPTER II**

### **REGULATION AND OPERATION OF GAMBLING IN CONNECTICUT**

Legal gambling in Connecticut takes many forms, from daily numbers games to a full-fledged casino. All gambling, with the exception of the Indian casino in Ledyard, is regulated by state government; however, gaming operations are run by private organizations as well as a state agency. The Division of Special Revenue and the Gaming Policy Board are responsible for controlling and operating legal forms of gaming in Connecticut.

Most governmental agencies do not run the industries they regulate. However, gambling is different in that many states operate as well as regulate the industry. In Connecticut, some features of a particular type of enterprise may be run by the state while others may be run by a private concern.

For example, the state runs part of the lottery and key services are provided by a private firm. Instant lottery tickets are printed by a private vendor but distributed by the agency. Lotto and daily numbers games are distributed through on-line terminals managed by a private vendor. All tickets are sold through retail outlets and the division regulates the games by auditing the results generated by the vendor's computer system. This mix of state run business, privately run business, and state regulation is a typical example of the government's role in legalized gambling.

#### **GAMING POLICY BOARD AND DIVISION OF SPECIAL REVENUE**

The legislature created the Division of Special Revenue, headed by an executive director, and the Gaming Policy Board to oversee gambling operations. According to the agency, its mission is to:

maintain public confidence of the highest level in the integrity and security for all aspects of the various legal gaming activities administered or regulated by the division, thereby making it possible ... to maximize revenues in support of state programs.<sup>5</sup>

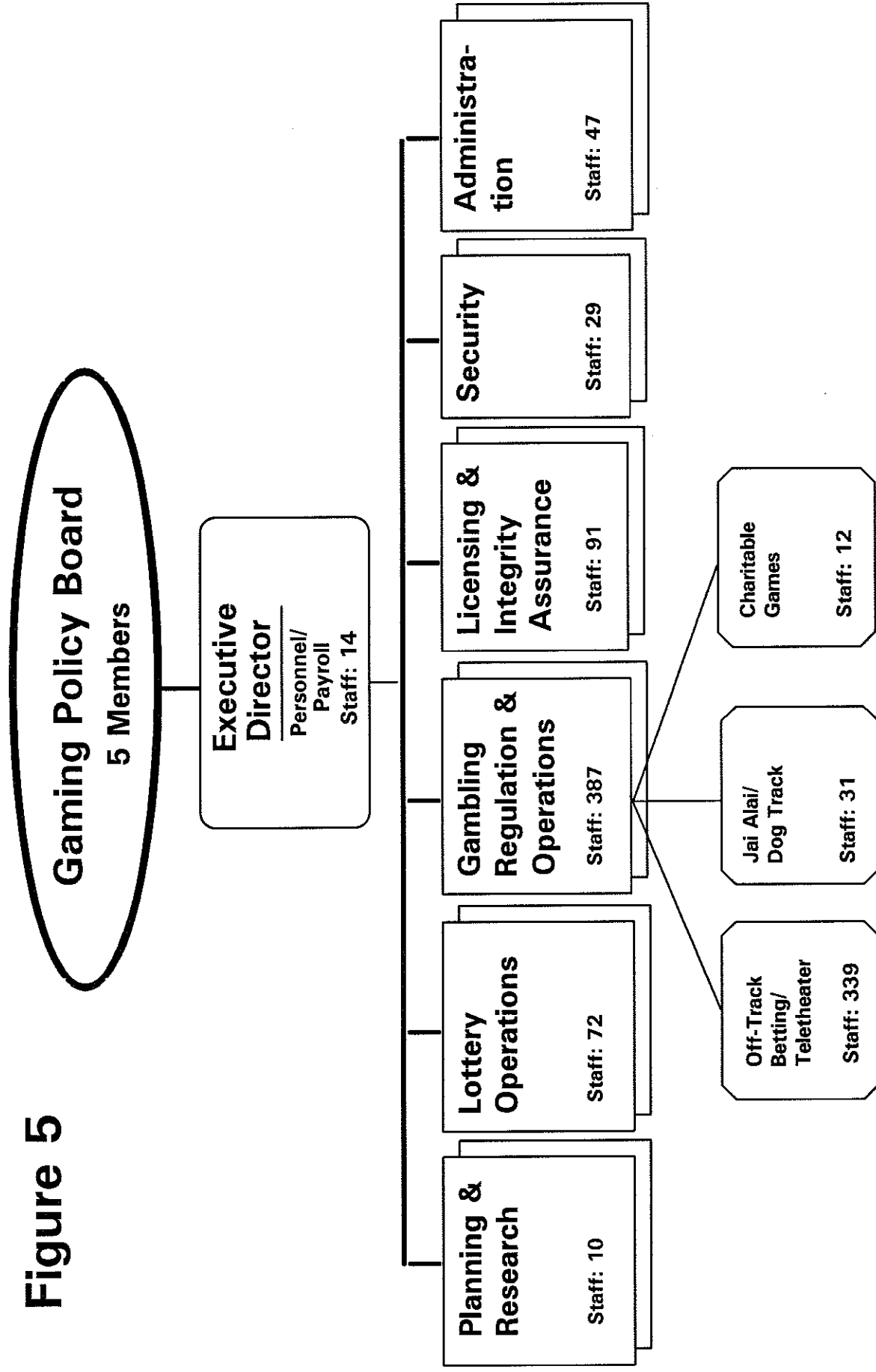
The agency has organized into seven major units designed to meet its regulatory and operational mission. Figure 5 portrays the organizational structure and functions of the agency as well as current staffing levels<sup>6</sup>. The figure also details the Gambling Regulation Unit, which

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<sup>5</sup> Governor's Budget, State of Connecticut, 1992-93, p. 146.

<sup>6</sup> Staff figures include all full-time and part-time positions. There are a considerable number of part-time positions, especially in the off-track betting area, where the hours of operation extend into evenings and weekends.

**Figure 5**



## Division of Special Revenue: Current Organization

is divided into three sections that account for a major portion of the agency's workload: off-track betting, parimutuel regulation (jai alai frontons and the dog track), and charitable games. The policy board and division are discussed below. A detailed description of each unit follows.

**Gaming Policy Board.** The Gaming Policy Board is comprised of five members, appointed by the governor with the advice and consent of the General Assembly, who serve staggered four-year terms. Three board members may not be from the same political party. Four members must be experienced in at least one of the following fields: corporate finance; economics; law; accounting; law enforcement; computer science; and the parimutuel industry. Two fields must be represented at all times.

Gubernatorial appointees to the board are also subject to certain conflict of interest provisions and are prohibited from participating in political activities such as a holding partisan office, campaigning for candidates in a partisan election, writing on a candidate's behalf, making contributions of time and money to political parties, or soliciting votes. (These same restrictions apply the executive and deputy executive directors of the agency.) Members are compensated for necessary expenses and paid \$50 for each day they are engaged in board business. The division executive director serves as a nonvoting, exofficio member of the board. Actions of the board require the affirmative vote of at least four members. A quorum is four members or, in case of a vacancy, a majority.

The statutory powers the Gaming Policy Board include:

- approving, suspending, or revoking licenses issued under state gaming law;
- approving contracts for facilities, goods, components, and services necessary to carry out the lottery and off-track betting;
- setting racing and jai alai performance dates;
- approving the types of parimutuel betting allowed;
- advising the executive director concerning the conduct of the state lotteries and off-track betting;
- assisting the executive director in developing regulations and approving them prior to adoption; and
- hearing appeals by licensees.

The board is also charged with the responsibility of advising the governor on statewide plans and goals for legalized gambling.

The board usually meets monthly with the agenda consisting of items related to the division's operations or the regulation of the industry. For instance, if the division seeks to begin a new lottery game, such as the recently instituted "Cash Lotto", the board will review the plan and approve or reject the game. If a fronton or dog track wishes to add a performance, they would also seek approval from the gaming policy board. Contracts with vendors are another item frequently on the board's agenda.

**Division of Special Revenue.** The division is responsible for administering all aspects of legalized gambling in Connecticut. The division is headed by an executive director appointed by the governor, with the approval of the general assembly. The executive director has the power to appoint a deputy and an executive assistant.

The executive director is charged with the following statutory duties:

- report to the governor on the division's financial operations, administrative costs, and advertising budget, and produce a summary of the division's activities;
- establish organizational units and appoint unit heads to carry out the agency's mission;
- conduct studies, with the advice and consent of the Gaming Policy Board, of the effect legalized gambling has on Connecticut citizens at least once every five years and provide the legislative committee having cognizance over legalized gambling with the findings and costs of such studies;
- submit monthly reports to the public safety commissioner and the legislative committee having cognizance over legalized gambling on any investigations conducted by the division; and
- publish all regulations and make copies available to the public.

The executive director also has considerable authority to determine how the lottery and off-track betting is operated including the type of games and wagering to be offered. In the area of off-track betting, the executive director is authorized to directly "contract with any person or business organization to provide such facilities, components, goods or services as may be

necessary for [its] ... effective operation...."<sup>7</sup> Almost all the actions of the executive director need final approval by the Gaming Policy Board.

## DIVISION OPERATIONS

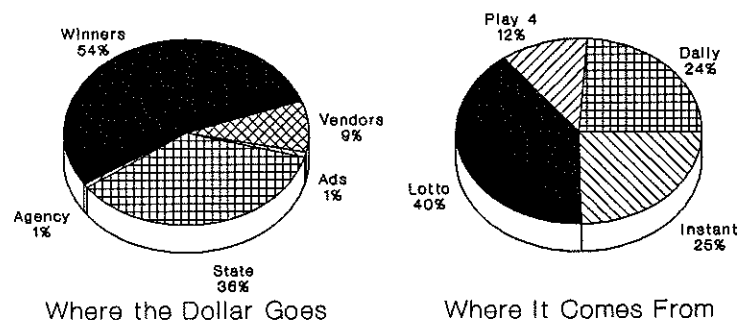
As displayed in Figure 5, the division consists of the Office of Executive Director and six major units: 1) planning and research; 2) lottery operations; 3) gambling regulation and operations; 4) licensing and integrity assurance; 5) administration; and 6) security. Program operations are divided among these organizational units with each unit head appointed by and reporting directly to the executive director. Major operations carried out by these units are described below.

## LOTTERY

Activities related to the design, advertising, promotion, and distribution of the state's lottery games are carried out by the division's lottery unit, staffed in FY 92 by 72 full-time and part-time positions. At present, the division operates four types of computerized on-line lottery games (Daily Numbers, Play Four, Lotto, and Cash Lotto) and several variations of instant ticket games. The weekly average bet on all lottery games is just over \$10 million. The following two pie charts give a breakdown of how the lottery dollar is distributed and the percentage wagered on each of the four major games. Figures were not available for Cash Lotto as the game was instituted in April 1992.

The division contracts with numerous private firms to provide critical parts of the lottery system. Throughout the state, over 3,700 agents, licensed by and under contract to the division, sell instant and on-line game tickets. General Instruments, Inc. (a subsidiary of Amtote International, Inc.) provides over 2,600 terminals connected to a computer network that collects numbers and identifies winners. General Instruments is responsible for providing facilities, services, and goods for the purpose of developing, implementing, and maintaining the on-line wagering system. Instant

Figure 6. The Distribution of the Lottery Dollar



<sup>7</sup> Connecticut General Statutes, Chapter 226, Section 12-572 (b).

lottery tickets are printed by Webcraft, Inc. and distributed by the unit's field staff. The division also has contracts with Channel 20, Inc., to telecast the lottery drawings and with Cronin & Company, Inc. to advertise the lottery products.

Finally, million-dollar winners receive payments over a number of years. Currently, John Hancock Mutual Life Insurance Co. provides the state with annuities that are used to make the payments over time. The following table displays information about the contracts held by the state for lottery services in FY 92.

Table 2. Lottery Contracts with Private Firms: FY 92			
Vendor	Service	Contract Term	Amount (Estimated: FY 92)
Amtote International (General Instrument)	Computerized network for On-line Lottery Games	May '88-May '93 (Recently negotiated 5 yr extension: May '93 -May '98)	\$8 million (\$40 million for first 5 yrs.; \$48 million for second 5 yrs.)
Agents (Grocery, Drug, & Package Stores)	Ticket Sales to the Public	One-year renewable licenses	\$27 million (5 % of sales)
Webcraft, Inc.	Printing of Instant Lottery Tickets	Oct. '89 -Oct. '91 with a 3 yr. extension option (currently extended for 1 yr.)	\$1.6 million (\$12.98 per 1,000 tickets with additional expenses)
Cronin & Co.	Advertising	Jan. '92 - June '93 (1 yr extension option)	\$252,000
Channel 20, Inc.	Televising the Lottery	June '90 - June '94 (1 yr extension option)	No cost; except studio expenses not to exceed \$5,000.
John Hancock Mutual Life Insurance Co.	Lotto Annuities	3 months	Cost factor: 1.887 % of annuity (Used to calculate total payout.)
Source: Division of Special Revenue			

The lottery unit manages all the private contractors related to the lottery and devises new games and estimates, with the assistance of planning and research, how the games will be structured in terms of payout and frequency of play. More than half of the lottery unit's employees are involved in the sale and distribution of instant tickets. Instant tickets must be



delivered to agents and winning tickets have to be validated by the division. Five distribution and sales districts cover the state with seven staff generally assigned to each district.

Accounting, auditing, collections, and claims settlements related to lottery games are the responsibilities of Licensing and Integrity Assurance (LIA) Unit staff rather than the lottery unit.

## **GAMBLING REGULATION AND OPERATIONS**

Gambling Regulation and Operations is the largest staff unit within the Division of Special Revenue. The unit is responsible for three major areas of gaming: off-track betting; parimutuel gambling (jai alai and dog racing); and charitable games. Nearly 60 percent of the agency staff is assigned to this unit. The unit is involved in a wide range of activities related to gambling regulation as well as the operation of off-track betting facilities.

**Parimutuel regulation.** Unlike the lottery and off-track betting, the state does not own or operate parimutuel facilities. Instead, it is concerned primarily with regulating the industry. The unit exercises its authority through the issuance of licenses to players, employees, owners, and operators of the three jai alai frontons and the dog track. A separate unit, Licensing and Integrity Assurance, screens individuals and entities seeking to engage in legalized gaming activities before the gambling regulation unit issues a license. Workload indicators are summarized in Table 3.

Table 3. Performance Indicators: Parimutuel Industry Regulation - FY 92.		
Activity	Number	Fees/Fines/Amount Paid to the State
Licenses Issued	2,880	\$37,600
Urine Samples (Dogs)	27,090	N/A
Regulatory Violations	139	\$13,737
Performances/Races*	1,283	\$15,845,132
* Includes Matinees and Evenings Source of Data: Division of Special Revenue		

The gambling regulation unit supplies judges for all facilities during races and jai alai performances. At the dog track, division inspectors collect urine samples from racing greyhounds and arrange for testing at the University of Connecticut. Disciplinary activities account for another major portion of the unit's work. Detecting, reporting, and handling

violations at the frontons and dog tracks is the responsibility of the unit's field staff. However, the planning and research unit conducts administrative hearings required to settle contested disciplinary actions and cases related to licensing disputes.

**Charitable Games.** Charitable games include bingos, bazaars, raffles, and games of chance run by non-profit organizations, such as volunteer fire departments, educational groups, veteran groups, and civic organizations. Permits must be secured from the division before any group is allowed to conduct a charitable game. Staffed with only 11 employees, it is the smallest section within the gambling regulation unit.

In terms of FY 92 activity, the section issued 553 permits for bingo, 413 for sealed tickets, 1,420 for raffles, and 104 for games of chance (Las Vegas nights). The division collected \$456,497 in permit fees and conducted 1,444 visits to inspect and supervise games. The section's central office staff processes applications, issue permits and collect fees while field staff conduct inspections and on-site audits of charitable gaming events. Violations reported by field workers are handled by the section's central office staff and could result in a disciplinary hearing and action, if warranted.

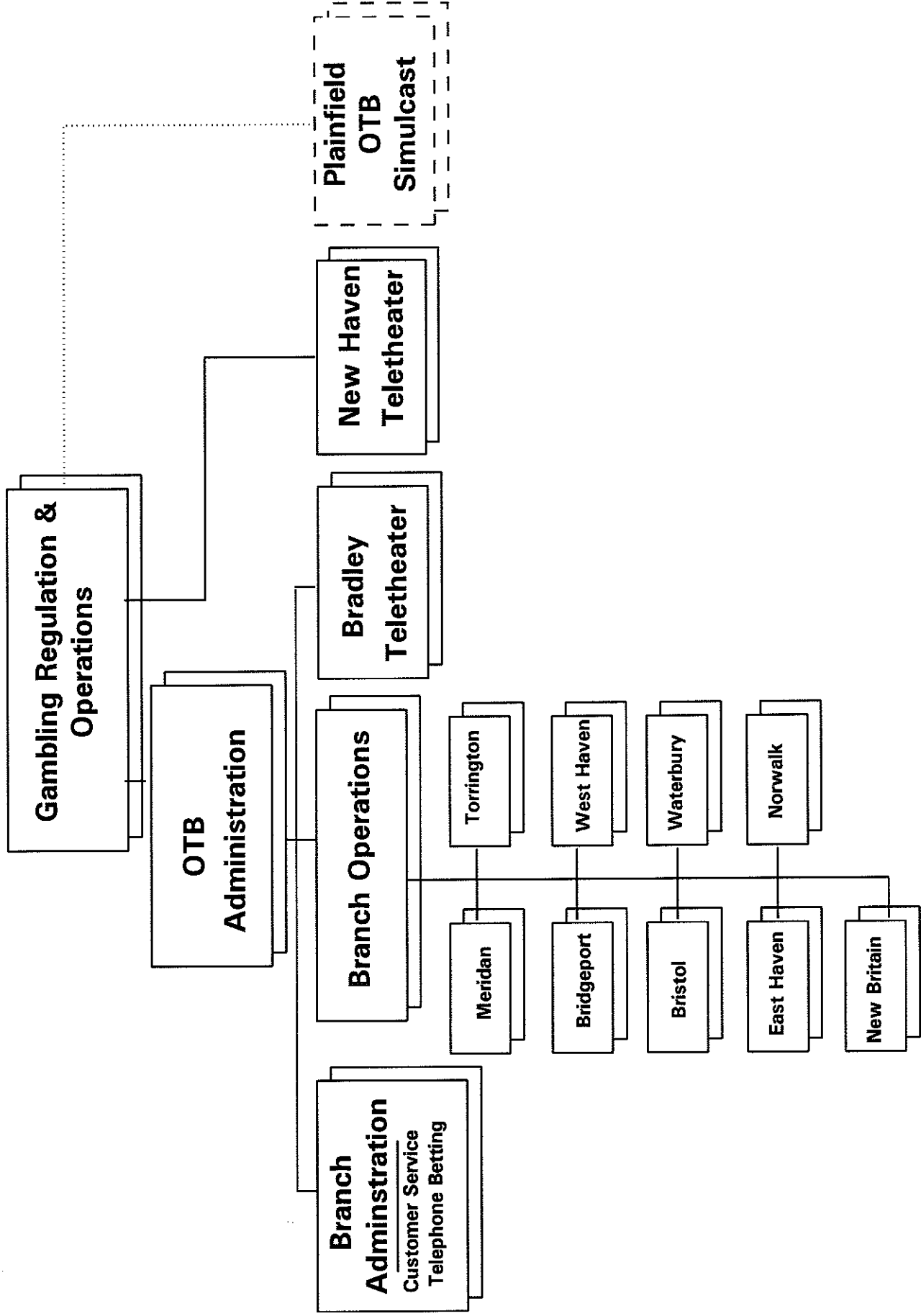
**Off-Track Betting.** While off-track betting contributes a small percentage of revenue to the state, it consumes the largest portion of the division's resources and employs the greatest number of agency workers. Off-track betting operations utilize 103 full-time and 236 part-time employees, though only contributing one percent of the state's net gambling revenues. Figure 7 details Connecticut's off-track betting operations. The division not only regulates but runs a significant amount of the business. As with the lottery, the division contracts with a number of outside vendors for services necessary to run the off-track betting system. Off-track betting has been a mix of public and private operations since it began in 1976.

The division operates a network of off-track betting facilities that include: nine branches or betting parlors; two simulcast (televised races) theaters; and a telephone betting service. An additional simulcast facility is located at the Plainfield dog track and operated by the owners.

**State's role.** Division employees staff all of the OTB facilities with the exception of the Plainfield simulcast facility. The staff manages and operates the facilities and provides employees for cashiers, maintenance, and security. All facilities are directly leased by the state. The division is also responsible for negotiating contractual agreements with tracks to allow the showing of horse races for the purpose of wagering. Contracts with horse racing associations in other states, primarily New York and New Jersey, provide thoroughbred and harness racing programs for all OTB facilities. Connecticut greyhound racing was recently added to the OTB program.

Telephone betting and customer service are additional functions handled by the agency. Accounting and auditing services related to off-track betting are carried out by Licensing and Integrity Assurance Unit personnel.

# Figure 7: Off-Track Betting Operations



**Vendor's role.** Private businesses play a significant role in Connecticut's off-track betting system. One vendor is responsible for developing and operating the system used to collect and compute wagers. The system, called a totalisator, consists of software, hardware, and communication links used to pool all bets on all horse and dog races shown at the various maintained facilities. All terminals used to provide betting tickets in the OTB facilities are installed and the vendor. In addition, the vendor supplies all the audio and video equipment, as well as staff, necessary to receive television transmissions from race tracks around the country. The following table illustrates the number and type of vendors involved in off-track betting.

Table 4. Off-Track Betting Vendors.		
Vendor	Service Provided	Contract Term
25 Race Track Contracts (i.e. Churchill Downs, Meadowlands, Rockingham)	Simulcast Races & Racing Information	Contract Length Varies: Generally 3 years
Connecticut Yankee Greyhound Racing	Simulcast Branch	4-17-91 to 6-30-92
Teletheater Management	Management of Windsor Locks Teletheater (Lease Arrangement)	10-24-92 to 6-30-92
Auto-Management, Inc.	Computerized tote system	2-13-92 to 10-31-92
Autotote Systems, Inc.	Computerized tote system	11-1-92 to 10-31-93
Sports Vision Productions, Inc.	Satellite and simulcast services	11-1-92 to 10-31-93

Changes in the operation of off-track betting have occurred recently and are outlined more fully in Chapter III: Findings and Recommendations. The Department of Revenue Services manages all gambling operations with the exception of the Plainfield simulcast facility. It uses two private vendors, Autotote Systems, Inc. and Sports Vision Productions, Inc., to assist in off-track betting operations.

## **MANAGEMENT SERVICES AND ADMINISTRATIVE SUPPORT**

Management and administrative support for the agency are handled by the Office of the Executive Director and four units: Administration; Licensing and Integrity Assurance; Planning and Research; and Security.

**Management Services.** Management services for the special revenue division include the policy and administrative activities carried out by the executive director's office. The division's personnel and payroll matters are also handled by a section within the executive director's office.

**Licensing and Integrity Assurance.** The screening of individuals and business entities wanting to engage in legalized gaming activities is done by the Licensing and Integrity Assurance Unit. Staff is also responsible for accounting and auditing functions related to the division's own gaming operations as well as those licensed by the agency. For example, the unit will conduct audits of parimutuel facilities to assure that the proper amount of taxes are being paid. Accounting activities related to charitable gaming are the responsibility of this section as well as the settling of all lottery claims.

**Planning and Research.** Planning and research provides a variety of services to the agency. The unit furnishes program managers with statistical analysis and research on gaming operations. The unit also assists in long-range planning, budget preparation, purchasing, and data processing. The unit coordinates the statutorily-mandated five-year study on the socioeconomic impact of gambling on the citizens of the state. The unit is also responsible for carrying out the provisions of the Uniform Administrative Procedures Act as they relate to contested matters concerning licensing and disciplinary matters. Unit staff act as hearing officers on cases and make administrative rulings as necessary.

**Security.** Agency security conducts investigations into regulatory violations and establishes procedures for all lottery drawings as well as the distribution of lottery tickets. The unit also provides security for division offices.

## **OVERVIEW OF OPERATING EXPENSES**

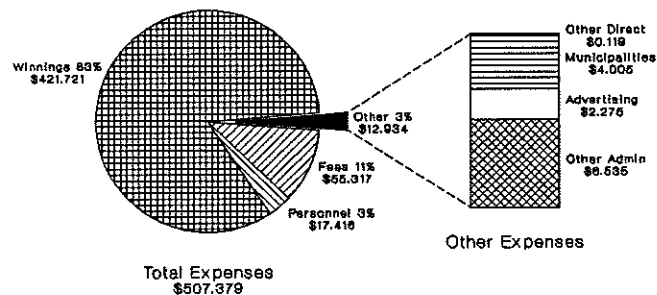
The state's costs associated with operating and regulating legal gaming in Connecticut totaled nearly \$507 million in FY 92. This amount represents about 70 percent of the state's gross revenues from legalized gambling for the same year (\$731 million). Gross revenue in this context is a combination of: 1) the total amount wagered (handle) on gaming programs operated by the state (lottery and OTB); and 2) the taxes and fees the state receives from the enterprises it only regulates (parimutuel facilities and charitable games).

A breakdown of total expenses by major category for FY 92 is provided in Figure 8. As the figure shows, winnings--the payouts made to lottery and off-track betting winners--are by far the state's largest expense (83 percent). Over the past five years, winnings have

consistently accounted for about 80 percent of total costs. If winnings are excluded from operating costs, the state's expenses as a percentage of net revenues (gross revenues minus winnings), drop to about 28 percent for fiscal year 1992.

In addition to winnings, the state's costs to operate and regulate legal gambling include: fees paid to vendors and contractors; personnel; and a variety of other direct and administrative expenses. Fees as an expense category include purchased services directly related to game operations such as lottery agent commissions, racing fees, and costs for on-line computer systems for lotto and daily numbers games as well as for off-track betting. Personnel expenses are special revenue division staff salaries. Fringe benefit and payroll tax costs, as discussed earlier, are not reflected in these agency expenditure figures. The category of other incorporates all remaining direct operating and administrative expenses.

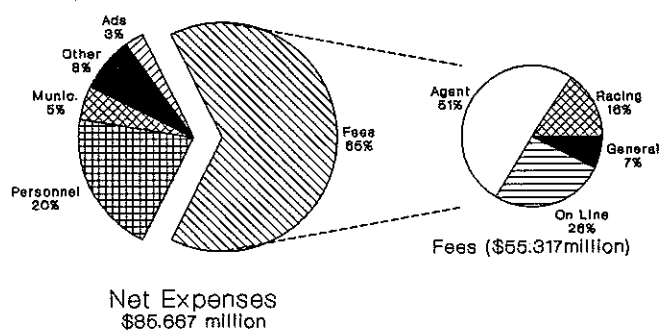
Figure 8. Total Expenses FY 92  
(in millions)



Source of Data: DSR Statement of Operations, FY 92

Other direct costs include several relatively large items--the special revenue division's budget for lottery advertising and the payments made by statute to municipalities in which parimutuel and OTB facilities are located. Among the most significant administrative expenses in the other category are telephone charges (over \$2.6 million in FY 92), and fees for miscellaneous services (about \$2.7 million in FY 92). The category of other administrative expenses also includes Division of Special Revenue supplies, equipment, travel, and similar routine agency expenditures.

Figure 9. Net Expenses FY 92  
(in millions)



Source of Data: DSR Statement of Operations, FY 92

A breakdown of net expenses, or total operating costs minus winnings, for FY 92 is presented in Figure 9. During that year fees accounted for nearly two-thirds of net expenses (65

percent). Personnel was the next largest cost category at 20 percent while municipal payments and lottery advertising totaled about 5 and 3 percent, respectively. All other expenses made up the remaining 8 percent of net operating costs.

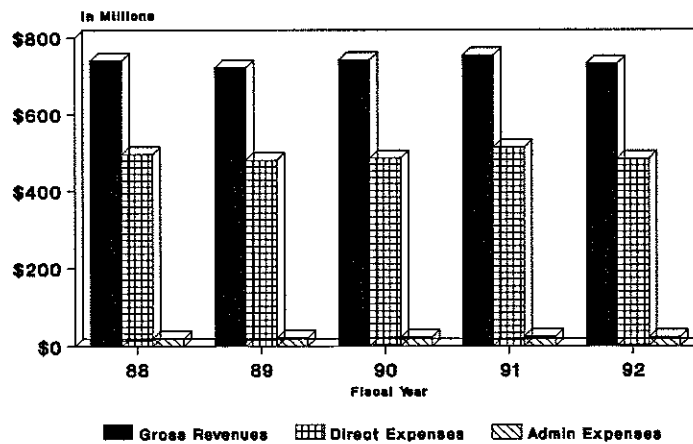
More detailed information on FY 92 expenses is provided in Table 5. Direct and administrative costs are shown by major category for each lottery program (daily, instant, and lotto) as well as off-track betting, parimutuel sports (jai alai and dog racing), and charitable games.

Table 5. Legalized Gaming Expenses by Program: FY 92 (dollars in millions).								
	DAILY LOTTERY	INSTANT LOTTERY	LOTTO	CASH LOTTO	OTB	PARI- MUTUEL	CHAR- ITABLE	TOTAL*
<b>DIRECT</b>								
Winnings	\$ 93.301	\$72.315	\$116.221	\$6.767	\$133.109			\$441.712
Agent Fees	\$ 9.763	\$ 6.885	\$ 10.982	\$0.451				\$ 28.081
Racing Fees					\$ 8.609			\$ 8.609
On-Line Systems	\$ 3.665		\$ 4.113	\$0.171	\$ 6.623			\$ 14.572
Gen. Fees	\$ 0.086	\$ 1.724	\$ 0.150	\$0.002	\$ 1.353	\$ 0.520	\$ 0.219	\$ 4.054
Municipalities					\$ 1.753	\$ 2.229	\$ 0.023	\$ 4.005
Advertising	\$ 0.115	\$ 1.379	\$ 0.433	\$0.341				\$ 2.275
Other			\$ 0.054	\$0.001	\$ 0.007	\$ 0.012		\$ 0.119
Total Direct	\$106.930	\$ 82.302	\$131.952	\$7.733	\$151.454	\$ 2.768	\$ 0.242	\$483.428
<b>ADMINISTRATIVE</b>								
Personnel	\$ 1.207	\$ 3.423	\$ 1.606	\$0.046	\$ 8.601	\$ 1.923	\$ 0.611	\$ 17.416
Other	\$ 1.352	\$ 1.027	\$ 1.685	\$0.080	\$ 1.875	\$ 0.207	\$ 0.307	\$ 6.535
Total Admin.	\$ 2.558	\$ 4.450	\$ 3.290	\$0.126	\$ 10.476	\$ 2.129	\$ 0.918	\$ 23.951
<b>TOTAL</b>	\$109.489	\$86.752	\$135.242	\$7.859	\$161.930	\$ 4.898	\$ 1.160	\$507.379
* Total includes pending receipts (\$48,000) Source of Data: DSR Statement of Operations, FY 92.								

Division expenses and their relationship to gross revenues over five fiscal years are shown in Figure 10. As the figure indicates, both expenses and revenues have fluctuated, exhibiting no clear trend, during this period. Since winnings as well as most other major expenses (vendor fees, municipal payments, etc.) are based on sales, the rise and fall in division operating costs parallel annual changes in revenues.

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Figure 10. Trends in Division Expenses  
FY 88 - FY 92



Source of Data: DSR Operating Statements  
Fiscal Years 1987 - 1992.

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## **CHAPTER III**

### **FINDINGS AND RECOMMENDATIONS**

The Legislative Program Review and Investigations Committee focused on evaluating how the division meets its goal to maximize revenues while insuring integrity and security of legalized gaming in Connecticut. Early in the study, the inherent conflict between the division's role as both promoter and regulator of gambling was identified as a key issue. A primary goal was to determine ways to create a strong regulatory agency, capable of assuring gaming integrity and protecting the public interest regardless of the scope of legal gambling in the state.

Initial interest in the topic stemmed from concern over the direction taken by the division regarding off-track betting (OTB). Rather than pursuing privatization as recommended by various consultants, the agency seemed to be moving toward more direct involvement in operating the OTB system. At the same time, broad questions about the division's regulatory performance were being raised as the legislature considered authorizing new forms of gambling in Connecticut.

Committee recommendations presented in the following pages focus on clarifying the state's role in legalized gambling by separating business operations from regulatory functions, and transferring tax collection to the Department of Revenue Services. To achieve this, a major restructuring of the state gaming agency is proposed. The committee believes its recommended policy and structural changes will improve operations as well as strengthen regulatory enforcement. In addition, recommendations are made to address deficiencies in information about and funding for problem gambling prevention, treatment, and rehabilitation programs.

#### **SEPARATING REGULATORY FUNCTIONS AND OPERATIONS**

Legalized gaming in Connecticut is an uncommon mix of publicly regulated private businesses, publicly operated gaming activities, and the collection of gaming revenues, all handled within a single state agency. While significant legal gambling operations are provided by private businesses, the state also runs sizable gaming concerns by way of the lottery and off-track betting. The Division of Special Revenue is unique among state agencies in that it performs three major functions: first, it collects taxes on certain businesses that are licensed by the agency; second, it regulates legalized gambling operations through licensing and continual oversight to assure integrity of gaming in Connecticut; and third, the agency operates and promotes certain games of chance. These three functions -- *regulating, operating, and taxing* - are generally carried out by separate state agencies. Two functions, operating a business and regulating the same industry, are in direct conflict.

No other state agency in Connecticut operates an aspect of the industry it regulates, nor collects taxes placed on the business as well. Every major regulatory agency has a single mission: to provide government oversight in an area deemed in need of economic controls, public health and safety assurances, or consumer protection. None of the major agencies in the

state run competing enterprises with the businesses they regulate and tax collection is left to the Department of Revenue Services.

For example, while the Department of Insurance and the Liquor Control Commission regulate their respective industries, taxes on insurance premiums and alcoholic beverages are collected by the Department of Revenue Services. The insurance department does not sell insurance policies nor does the liquor control retail alcoholic beverages. The Public Utility Control Commission regulates cable television, electric and gas utilities, and telephone companies, but does not own or operate any. The Commission on Hospitals and Health Care is charged with regulatory oversight of hospitals, nursing homes, and other health care providers, but does not provide any of those services even though these services are provided by other state agencies. Where the state does operate a business, the regulatory authority over that business is vested in another agency. As an example, the state operates the Regional Farmers' Market through the Connecticut Marketing Authority, but the regulation of products sold is the responsibility of the Departments of Consumer Protection and Agriculture.

Providing private goods and services by public agencies is contrary to the purposes of most governmental entities. When private goods or services are provided by government it is usually to fulfill a need that private markets are unable or unwilling to furnish. Gambling products and services are purely private goods that can be and are adequately provided by private businesses in Connecticut and nationally.

Gambling is considered to be part of the entertainment sector and is a difficult business for private vendors. It is an even more difficult enterprise to operate competitively for a state agency, which does not enjoy the operational flexibility of private sector firms. The consumer is very demanding of entertainment products and changes can occur rapidly given the introduction of new and competing goods. To be aggressive in the gambling marketplace, businesses must constantly measure the pulse of consumers, design their products accordingly, and promote a wide array of products and services to potential customers. Typical state bureaucracies do not have the operational flexibility to be competitive in a rapidly changing marketplace.

**The need for regulation.** The reasons for regulating gambling are: 1) to insure integrity of the games; 2) to establish marketplace rules; and 3) to maximize revenues to the state. Gambling is an illegal activity unless it is specifically authorized by the legislature and operated under state laws and agency regulations. Gambling is not operated in an openly competitive market, but rather businesses are given limited rights to operated in specific locations.

Gambling businesses have some of the same characteristics as regulated monopolies, such as electric utilities or cable television, which must be licensed or franchised to operate within a given area. This is true with all forms of regulated gaming. The legislature has established the number of facilities allowed, and in some instances the location of those facilities. The state gaming agency must either license an operator or run the business itself. The dog track and jai alai frontons are operated by private businesses, while the lottery and off-track betting, with the exception of the simulcast facility at the Plainfield Dog Track, are operated by the special

revenue division. However, within these state-run operations, private vendors, under contract, provide a substantial amount of the work.

The question of separating operational activity from regulatory functions has been frequently examined in the past. The most recent study of gaming in Connecticut<sup>8</sup> carefully reviewed many aspects of the industry and concluded that regulating and operating gaming were incompatible.

With regard to State-operated and/or regulated gambling, ... the necessity to act as an entrepreneur (if the State wishes to increase, or even maintain, sales) must be tempered by consideration of the appropriate role of the State with respect to providing gambling opportunities for its citizens. In addition, the institutional framework of State operations (including the budget cycle, mandatory personnel policies, and bureaucratic procedures) tends to reduce flexibility and responsiveness to market conditions. Given these conflicts between entrepreneurial action and public responsibilities, State agencies generating revenues via gambling often have difficulty in adapting to the marketplace. These difficulties tend to exacerbate reductions in revenues from mature and declining gaming products.<sup>9</sup>

Many of the difficulties faced by the state's gaming agency over the past several years have stemmed from the operations of gambling activity. There is an inherent conflict in acting both as a regulator and an agency that operates gaming, a conflict that can only be resolved by freeing the agency from having to operate a business.

**The legislative program review committee recommends that the following be adopted as legislative policy:**

**Gambling regulatory functions shall be separated from all gaming operational activities. All gaming operations shall be operated by private business entities, to be regulated by the state, and where there is an overwhelming state interest to operate gaming, it shall be operated under the jurisdiction of a quasi-public governmental entity.**

The adoption of this policy would require a significant change in the agency's mission to one that reflects the need to regulate gambling to the highest standard possible. Under this policy, the chief concern of the agency will be to: insure the integrity of legalized gambling;

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<sup>8</sup> *Legal Gaming in Connecticut: Assessment of Current Status and Options for the Future.* Christiansen & Cummings Associates, Inc., Six Volumes, January 13, 1992.

<sup>9</sup> Christiansen & Cummings, Volume 1, p.15-16.

execute regulatory policy as outlined by legislative authority; and monitor the impact gambling has on the public.

## **AGENCY RESTRUCTURING**

To fulfill the policy of separating business operations from regulatory oversight, a major restructuring of the agency is required. The current organizational structure of the Division of Special Revenue shown in Figure 5 consists of six major units: 1) lottery operations; 2) gambling regulation and operations; 3) licensing and integrity assurance; 4) administration; 5) planning and research; and 6) security. These units, with the exception of security, have been established by statute. Adopting the above recommendation demands that operational aspects of the agency -- the lottery and off-track betting -- be altered. Subsequent recommendations deal with these operational aspects; specifically, it is proposed that a quasi-public agency be created to operate the lottery while off-track betting be turned over to the private sector.

Furthermore, to implement the policy of strengthening the regulatory structure, the committee believes the Division of Special Revenue should be replaced by a Gaming Control Commission. This new agency would consist of three units administered by an executive director. The units' goals would be to regulate the legalized gaming industry each having a distinct and separate objective. The Gaming Policy Board will be replaced by the commission, with its role limited to regulatory matters rather than business decisions related to gambling operations. It would also be responsible for continually examining the impact gaming has on the people of Connecticut.

**It is recommended that the new Gaming Control Commission be structured as outlined in Figure 11. The agency shall consist of three units: 1) gambling regulation; 2) audit; and 3) administration. The purpose of this structure is to strengthen the regulatory process by combining all the licensing and integrity assurance functions in one unit while providing a separate unit to focus on financial audits of gaming operations. The third unit shall be responsible for administering the agency, providing research, and conducting administrative hearings on contested cases.**

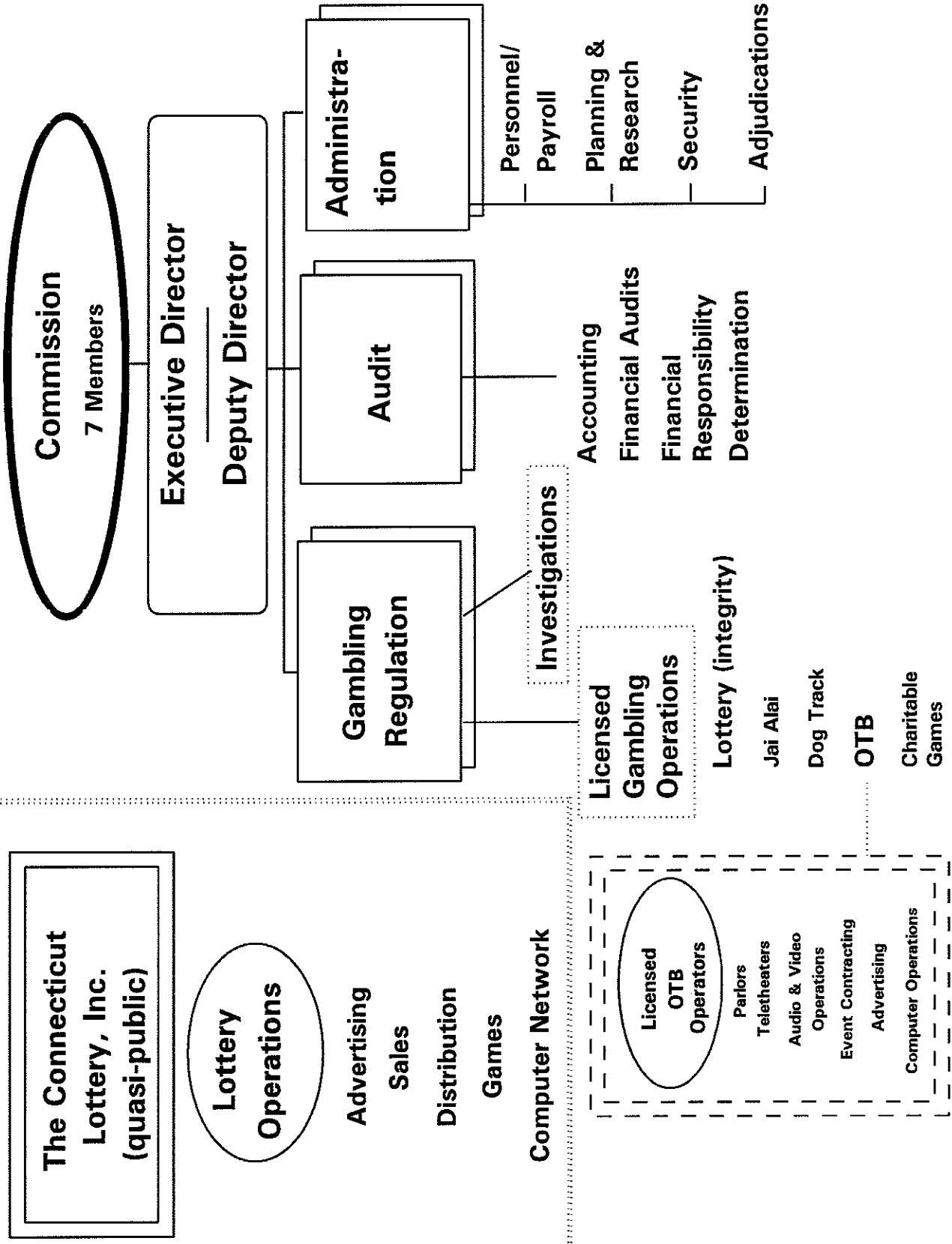
**The agency shall be headed by an executive director who shall be appointed by the Gaming Control Commission. The three unit heads shall be part of the state's classified service.**

**The Gaming Policy Board shall be replaced by the Gaming Control Commission and have approval authority over the following areas:**

- ◆ **licensing;**
- ◆ **contracts;**
- ◆ **regulations;**

**Figure 11: Proposed Organization**

**Gaming Control Commission**



- ◆ performance dates; and
- ◆ appeals.

The commission shall consist of seven members, three shall be appointed by the governor and four shall be appointed by the leaders of the general assembly. Appointments shall be coterminous with the appointing authority. The governor shall appoint the chairman of the commission.

The commission shall also be responsible for continuously monitoring the impact gambling has on society in Connecticut and report its findings annually to the governor and the General Assembly.

Questions related to whether or not an entity is operating within statutory authorization shall be investigated by the executive director; the executive director shall determine whether licensees are in compliance with statutes and regulations that define operations. Decisions of the executive director concerning licenses may be appealed to the Gaming Control Commission.

All functions related to collection of gaming tax revenues shall be transferred to the Department of Revenue Services.

The commission will not be involved in specific business decisions directly related to the operation of a gambling entity. This recommendation will limit the commission's role to major regulatory matters and allow the agency, through the executive director, to make decisions on regulatory compliance.

**Gambling Regulation.** The gambling regulation unit will be responsible for conducting investigations, licensing individuals and businesses, and regulating the industry. The unit will be responsible for issuing an initial license and renewing licenses based upon a uniform licensing procedure, as recommended below. Specifically, the unit will further be responsible for the continual oversight and monitoring of gaming integrity both through on-site staff at gaming facilities and agency based staff. The gambling regulation unit will also ensure the integrity of all lottery games.

The gambling regulation unit should also establish an investigation subunit designed to conduct special inquiries on problem areas. The investigators will work in conjunction with the Audit Unit to determine initial financial responsibility of all licensees and assist the unit in monitoring continual financial integrity of gaming businesses.

Overall, the unit will be responsible for licensing and regulating the following activities:

- ◆ lottery operations;

- ◆ jai alai;
- ◆ parimutuel racing (dog and horse);
- ◆ off-track betting; and
- ◆ charitable games.

**Audit unit.** The audit unit will be responsible for the continual auditing of all operators of gambling operations to determine financial responsibility and integrity. It will administer the financial disclosure statement requirements outlined in Chapter 226b of the Connecticut General Statutes. The audit unit will provide the Department of Revenue Services with any information necessary to ensure the collection of state taxes and approve accounting standards for all gaming operations.

**Administration unit.** Support functions relating to the operation of the Gaming Control Commission will be consolidated under an Administration Unit. These include building security, personnel, planning and research, administrative adjudications, as well as the purchasing, contract administration, budgeting and other business functions necessary to operating a state agency.

**Tax functions.** All taxation functions relating to the taxation of the parimutuel industry will administered by the Department of Revenue Services. The Gaming Control Commission will provide revenue services any accounting information received from the industry as a result of its audit procedures. Revenue services will collect gaming tax payments and account for the taxes collected.

## **LICENSING PROCESS**

The most powerful tool of government regulators is an effective licensing process. Through licensing, regulatory agencies can: 1) limit an activity to those meeting certain standards of competence, character, and performance; and 2) enforce compliance with requirements established to protect the public health, safety, and welfare. A strong licensing effort is critical to insuring the integrity of legalized gaming.

Connecticut statutes give the Gaming Policy Board and the division's executive director broad licensing authority. Through its licensing program, the division requires applicants to supply information pertaining to financial standing and credit, moral character, criminal record, previous employment, personal assets, and business affiliations. Key officials of entities licensed to conduct gaming as well as affiliated businesses are subject to detailed financial disclosure requirements and must annually update financial information supplied to the division. Current law permits the agency to investigate and visit the gaming facilities and business offices of licensees as well as place accountants or other experts at those locations. In addition to

suspending or revoking a license for good cause, the division is authorized to impose substantial fines for noncompliance with gaming statutes or regulations.

The categories of individuals and enterprises that must be licensed are established by statute. These include:

- Association - a person or business organization conducting a gambling performance;
- Affiliate - a business organization exercising control over an association licensee;
- Concessionaire - any person or business operating as such at a gambling facility;
- Vendor - any person or business awarded a contract by the state to supply services for gambling operations;
- Totalizator - any person or business providing totalizator equipment (specialized computers) for the operation of a pari-mutuel system;
- Occupational - any (and every) person who is employed by an licensed association, concessionaire, vendor, totalizator or affiliate; and
- Lottery agents - any person selling lottery products.

At present, the division issues over 3,300 licenses a year to businesses involved in dog racing and jai alai and all their employees ranging from jai alai players to parking lot attendants. Information on the types and numbers of the business and occupational licenses issued in FY 92 are detailed in Table 6.

In addition to the licenses shown in the table, nearly 600 new lottery agent licenses were issued in FY 92. The division uses more than 10 different application and renewal forms for lottery agents and the following classes of licensees: Class I, which includes all employees of enterprises licensed to conduct dog racing and jai alai; Class II, which applies to the owners, managers, and operators of gaming facilities and related services; and Class III, which is not in use at present but would apply to third party investors or shareholders in licensed gaming enterprises.



Table 6. Class I and II Licenses Issued: FY 92.		
Type of License	Total	Percent
Class II Occupational (Owners/Officers)	77	2%
Concessionaire	22	1%
Vendor/Affiliate	8	0%
Admissions	38	1%
Computer Operator	27	1%
Race Control	13	0%
Field Technician	10	0%
Office	67	2%
Maintenance	189	6%
Other	477	14%
Concession	491	15%
Mutuel Operator	456	14%
Parking Attendant	132	4%
Usher	21	1%
Security	142	4%
Race Official	63	2%
Players	177	5%
Bench Technicians	6	0%
Customer Service	31	1%
Veterinarian	7	0%
Lead Out (Dog Track)	50	2%
Dog Owner	619	19%
Trainer/Assistant	65	2%
Kennel Name	33	1%
Partnership	84	3%
Authorized Agent (Dog Track)	13	0%
TOTAL	3,318	100%

The committee believes the number of license categories and forms makes the current licensing process cumbersome and inefficient. The division's four-person licensing section spends about half of its time processing paperwork related to applications and annual renewals

for Class I occupational licenses. An FBI background check is conducted for every applicant and Connecticut criminal records are reviewed for every annual renewal even though at least 25 percent of the occupational licensees are not directly involved in regulated activities. The fees collected from all licensees (about \$41,000 in FY 92) do not even cover the salary costs of licensing section staff.

The program review committee believes licensing efforts should be focused on individuals who directly influence the conduct and outcome of legalized games. Agency resources would be better spent monitoring the competence and integrity of those individuals who have a significant impact on wagering games.

Therefore, it is recommended that the licensing process be applied to only those individuals or businesses with direct control over gaming integrity. Current statutes shall be amended to provide for two categories of licenses: 1) Class I and Class II. Class I licenses shall be designated for those who own and/or operate authorized gaming facilities. Class II licenses shall be for employees of a Class I licensee who are players, judges or have substantial control over the operation of a race, performance, or game. All other employees need not be licensed by the Gaming Control Commission. License requirements currently mandated by statute shall continue unchanged.

**Class I Licenses shall apply to the following forms of gaming:**

- ◆ jai alai;
- ◆ dog racing;
- ◆ horse racing; and
- ◆ off-track betting.

By adopting the recommended criteria, a number of existing occupational licenses could be eliminated without any impact on the integrity of gaming in Connecticut. The committee estimates approximately 2,100 fewer licenses would be issued each year under this recommendation, permitting the regulatory agency to concentrate its attention on businesses and individuals directly involved in gambling operations. Resources now used to process unnecessary license applications and renewals could be applied instead to investigating and monitoring the remaining licensees. For example, more efforts could be made to assess the financial health of licensed entities since operators who are experiencing business problems may be tempted to compromise game integrity to shore up their profits. The recommendation will also foster a uniform approach to the licensing process.

This recommendation includes a new licensing category -- off-track betting -- that would allow private businesses to operate OTB facilities. The business would then be regulated by the

state in a manner similar to other currently regulated parimutuel facilities. The committee's recommendation regarding OTB is detailed in the following section.

## **OFF-TRACK BETTING OPERATIONS**

As noted earlier, off-track betting contributes a small percentage of revenue to the state, yet it consumes the largest portion of the division's resources and employs the greatest number of agency workers. Off-track betting operations accounted for roughly one-third of total agency expenses in FY 92 but contributed only 2.4 percent of the state's net gambling revenues. The division not only regulates but runs a significant amount of the business. The division contracts with a number of outside vendors for services necessary to run the off-track betting system. Off-track betting has been a mix of public and private operations since it began in 1976.

Division employees staff all of the OTB facilities with the exception of the Plainfield simulcast facility. The staff manages and operates the facilities and provides employees for cashiers, maintenance and security. All facilities are directly leased by the state. The division is also responsible for negotiating contractual agreements with tracks to allow the showing of horse races for the purpose of wagering. Contracts with horse racing associations in other states, primarily New York and New Jersey, provide thoroughbred and harness racing programs for all OTB facilities. Connecticut greyhound racing was recently added to the OTB program.

As stated earlier, private businesses play a significant role in Connecticut's off-track betting system. One vendor is responsible for developing and operating the system used to collect and compute wagers. All terminals used to provide betting tickets in the OTB facilities are installed and maintained by the vendor. Another vendor is responsible for broadcasting live horse and dog races shown at the various facilities. This vendor supplies all the audio and video equipment, as well as staff, necessary to receive television transmissions from race tracks around the country.

**Recent OTB operations.** From the inception of OTB in Connecticut until February 1992, a single vendor, Amtote International, Inc., was under contract with the division to provide OTB tote services. A new contractor, Auto-Management, was subsequently selected to take over the system from March through June 1992.

A request-for-proposal to operate off-track betting was issued in February and bid proposals were received in June. The division was unable to arrive at a recommendation for a long-term contractor and extended the Auto-Management contract through October 1992. The division proceeded to select a single permanent vendor for a multi-year contract and forwarded a recommendation to the Gaming Policy Board. In July, the special revenue staff recommended that the OTB contract be awarded to International Totalizator Systems, Inc. for five years. The board rejected the division's recommendation in August, 1992, on a vote of three in favor and two against awarding the contract. (The statute requires the affirmative vote of four members to approve any action.) The reason given for the two negative votes was the desire on the part of two board members to discontinue the operations of off-track betting by the division.

Facing an October 31 deadline, the board approved a one-year contract for the operation of totalisator computer system, awarded to Autotote Systems, Inc., and a one-year contract to operate all simulcast and satellite operations granted to Sports Vision Productions, Inc. The division became responsible for managing all off-track betting operations, including the network and wagering pool. In October 1992, the board chairman has asked the executive director to report on the status of the "privatization" of off-track betting "every time the board meets."<sup>10</sup> At this point in time the division has in fact assumed greater control over off-track betting operations than at any time previously.

**Past studies of off-track betting.** There have been a series of studies conducted that addressed the problems encountered by the state's OTB operations. The first occurred in March 1979, when a management study was done of the Commission on Special Revenue (the division's predecessor). Operation of the New Haven teletrack was being taken over by the division and the consultant noted that it would be "... necessary for the OTB division to almost double its total supervisory and cashier staffing to accommodate the requirements of operating the ... facility"<sup>11</sup>. The study urged the agency to consider contracting OTB operations believing it would "remove the state from direct responsibility for the problems associated with running complex gaming operations"<sup>12</sup>. The consultants also thought it would be possible for a private organization to achieve efficiencies not readily available to public agencies. Most important, however, the study's authors recognized that contracting would "support and build upon the theme of the Commission [Division of Special Revenue] as a regulatory -- as opposed to an operating -- body."<sup>13</sup> The recommendations regarding the operation of OTB were not carried out while the problems identified in 1979 have continued to trouble the agency.

Another major review of the agency was done by the Commission to Study the Management of State Government in 1990.<sup>14</sup> The review found that competition for wagering discretionary dollars was increasing and recommended that greater flexibility be provided to allow the operating entities to respond to changes in the industry. The report further noted that off-track betting revenues had declined steadily from 1986 to 1991 and that based upon the data gathered "increasing costs of operating OTB appear to be the primary factor for the decreasing

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<sup>10</sup> Request made by Chairmen Edward Kratovil, *Minutes of Gaming Policy Board*, Department of Special Revenue, October 5, 1992.

<sup>11</sup> *Management Study of the Connecticut Commission on Special Revenue*, Cresap, McCormick and Paget, Inc., March 1979, pp. VII-10 to VII-11.

<sup>12</sup> *Ibid.*, page VII-11.

<sup>13</sup> *Ibid.*, page VII-11.

<sup>14</sup> Commission to Study the Management of State Government (Thomas Commission), *Final Report: Department of Revenue Services, Division of Special Revenue, Department of Economic Development*, November 1990.

trend ...." The report also saw a need to revitalize OTB if it was going to remain a viable business. To achieve such ends the Commission recommended that a "test" private facility be operated to determine the most beneficial configuration of off-track betting. Such a private facility has since been established at the Connecticut Yankee Greyhound Race Track in Plainfield.

The latest study of off-track betting operations can be found in the Christiansen/Cummings Associates' report previously cited. As noted earlier, the authors recognized the inherent conflict in having a single agency both operating and regulating gaming. They identified Connecticut as operating off-track betting in a manner distinctly different than all other states where it is a licensed private enterprise, and identified a declining trend in the amount of money bet since 1979.

Christiansen/Cummings Associates projected that the current OTB system, following the opening of the Mashantucket Pequot casino, would likely "experience significant deficits in terms of contributions to net state revenues in the years ahead"<sup>15</sup> due not only to the effects of the casino but also to a long-term trend of costs rising faster than revenues. The consultants were also "skeptical" of any fine-tuning of the OTB system as presently configured, finding that many of the costs associated with operations were inflexible. They recommended that OTB be operated as a private licensed facility with the state having regulatory control over the business. Substantial gains were projected in revenues if OTB were modeled on an "ultimate mix" concept of mini-theaters, teletheaters, telephone betting, and simulcast branches. The consultants believed that in a highly competitive market a simple betting service was doomed to failure and, like other forms of entertainment, gambling must be able to attract and retain customers.

Christiansen/Cummings Associates found that OTB would not survive if it was unable to control labor costs, and continued to operate on a fixed budgetary cycle, adhere to mandatory personnel policies, and be required to make business decisions within bureaucratic government procedures. They believed "a privately-operated OTB system would have greater flexibility in achieving the necessary efficiencies"<sup>16</sup> to respond to a changing marketplace and questioned "whether a government agency can compete with the American entertainment industry -- which provides everything from meals to movies -- for consumer time and disposable industry"<sup>17</sup>.

While the consultants did not conduct a detailed cost analysis of the current OTB operations, they did quantify the extent to which privatization could benefit the state. They projected that under the configuration presented in the report, certain costs could be reduced to parallel those of privately operated systems in other states. They did, however, recommend that many of the statutory restrictions placed on OTB facilities be removed allowing greater

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<sup>15</sup> Christiansen/Cummings Associates, Volume 2, p. 426.

<sup>16</sup> Christiansen/Cummings Associates, Volume 2, p. 687.

<sup>17</sup> Christiansen/Cummings Associates, Volume 2, p. 497.

discretion on the part of an operator to provide a more attractive product to the public. The role of the regulator would be of assuring that a licensed operator was performing within the bounds established by the legislature.

The program review committee staff conducted a cost analysis of off-track betting operations, which is discussed below. In essence it was found that the state could raise at least the same amount of revenue by applying a tax to licensed operators while freeing OTB from state imposed restrictions.

**OTB profitability.** Recent state experience with the OTB simulcast facility located at the dog track in Plainfield indicates that private operations may prove more profitable than a state-run system. Connecticut Yankee Greyhound Park (CYGP), under contract with the division, began operating a simulcast off-track betting facility in November 1991. The current contract with CYGP provides that the state receive a commission based on sales (set on a sliding scale but equal to just over 3 percent of handle overall), all breakage (the amount left after rounding payments to the nearest dime), and all the revenue from winning tickets uncashed after one year.

During its eight months of operation in FY 92, sales at the Plainfield simulcast facility totaled \$9.628 million. The state received over \$362,000 in revenue and, as required by law, paid the town of Plainfield one percent of sales from this amount. The "net profit" to the state was approximately \$266,000, representing 2.8 percent of sales at the facility. Total profits should be slightly higher when revenues from uncashed winning tickets, which revert to the state after one year, are received.

In contrast, the state-operated OTB system returned less than one percent of sales as profit to the state in FY 92. Without considering the Plainfield simulcast facility activities, the OTB handle was \$165.685 million for last fiscal year while other revenue (primarily uncashed tickets and admission and program sales) amounted to \$1.230 million. After paying winnings (by law, the equivalent of just over 80 percent of sales is returned to bettors) and administrative expenses, including employee fringe benefits (\$32.637 million, not including expenses related to the CYGP teletheater) net profit to the state was \$1.170 million or just 0.6 percent of sales.

The division does expect the ratio of profit to sales to improve during the current fiscal year due to operating cost reductions. For example, costs for the system's totalizator services, a major expense, are substantially less under the contract just negotiated (and effective November 1, 1992) than previous contracts. However, as the following analysis indicates, system expenses will have to be trimmed significantly and remain well-controlled in order to achieve the same level of profits as a privately operated OTB system taxed by the state. It should also be noted that the division now has the added responsibility of managing the entire OTB system where those services were previously supplied by the contractor.

The committee staff estimated the income the state would have received in FY 92 if a tax structure like that applied to the parimutuel industry was used for off-track betting. Using

a rate of 3.0 percent of sales, which is comparable to rates applied in other states and that received from the Plainfield simulcast facility, revenue potential is shown in Table 7. It is also assumed that, as with parimutuel facilities, the state receives 50 percent of breakage (estimated at .57 percent of handle), and all year-old uncashed winning ticket revenues (estimated at .4 percent of handle). As provided under current law, one percent of handle is returned to communities that host OTB facilities.

Division administrative expenses associated with collecting OTB revenues and regulating the facilities are estimated at 0.5 percent of handle. This is about half of what the division currently spends to administer its parimutuel program. Off-track betting administrative costs are assumed to be significantly less since many regulatory activities conducted at the dog track and jai alai frontons, like drug testing and full-time, on-site field supervision, would not be necessary at OTB facilities.

Table 7. Estimated FY 92 Revenues from State Regulated Privately-Run OTB System	
SALES*	\$175,313,000
REVENUE	
Tax (3 %)	5,259,000
50 % breakage (est. .57 %)	999,000
Uncashed tickets (est. .4 %)	701,000
Total	6,959,000
EXPENSES	
Municipal Payment (1 %)	1,753,000
Administrative	877,000
Total	2,630,000
NET PROFIT	\$4,330,000
* Sales = \$165,685,000 state system + \$9,628,000 Plainfield simulcast facility	

Based on program review committee staff analysis, shown in Table 7, the state would have received approximately \$4.3 million under a taxed OTB system. Actual net profit produced by the OTB system in operation during FY 92 was \$1.4 million. As noted above, the division anticipates improved profitability during the current fiscal year since its operating expenses such as totalizator service fees have been reduced. However, to equal the tax income produced under

the committee staff model, the division would need to reduce its expenses by almost \$3.0 million. This is equivalent to nearly half of the FY 92 totalizator service expenses.

The program review committee concurs with the conclusions drawn from the past studies of off-track betting. The only way for this activity to remain viable is to license privately-run operations. Analysis further indicates that the current private simulcast operation is more profitable than the state-run operations. The simulcast operation at Plainfield demonstrates that a privately-run facility can operate successfully and have revenue enhancing benefits as well.

**Therefore, the program review committee recommends off-track betting facilities be operated as licensed franchise businesses. It is further recommended that statutory restrictions on the type and character of facilities be removed and the Gaming Control Commission set standards for off-track betting facilities.**

This proposal will enhance off-track betting operations and, most importantly, free the state from the disruptive conflict of having to operate a difficult and highly competitive business while at the time being responsible for regulatory oversight. Off-track betting as a sector of the gaming industry is more likely to succeed in the long-term if it is exposed to marketplace competition and has the entrepreneurial flexibility to adjust to economic pressures.

## **LOTTERY OPERATIONS**

By many measures, the Division of Special Revenue runs a successful lottery operation. Connecticut's lottery games typically are responsible for about 90 percent of the state's revenues from legalized gambling. Annual lottery sales have totaled about \$500,000,000 over the last five fiscal years; net profits for the same period have averaged about \$200 million each year. As expected given Connecticut's high per capita income, per capita lottery sales are consistently the highest in the nation. For FY 91, Connecticut, tied with New Jersey at \$161 in per capita sales, was fifth in the nation behind Massachusetts (\$265), the District of Columbia (\$237), Florida (\$165), and Maryland (\$170).

As the Christiansen/Cummings Associates report noted, Connecticut generally has one of the lowest cost lottery operations in the country. According to the most recent available data on state lottery costs, only four states--New Jersey and Maryland each at 3.3 percent, Pennsylvania at 3.7 percent, and Illinois at 4.9 percent--had FY 90 expense-to-sales ratios lower than Connecticut's 4.9 percent.

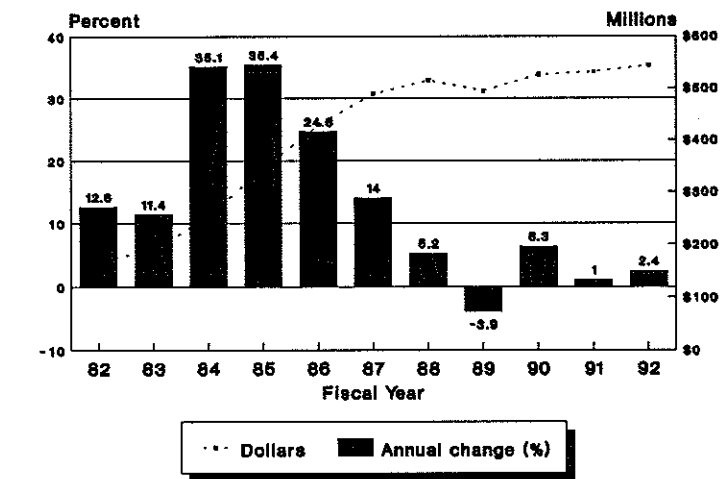
While Connecticut per capita sales are high and expenses are low, recent sales trends raise concern about the future of the state's lottery program. Connecticut, like other states with mature lotteries, has experienced relatively stagnant sales in recent years. Figure 12 illustrates the dramatic change in Connecticut lottery sales growth over the past 10 years. Mirroring a nationwide trend, lottery sales grew at a double-digit rate through the mid 1980s but abruptly leveled off beginning in FY 88 and even showed a downturn one year (FY 89). In three of the



past five fiscal years, growth in Connecticut lottery sales has been below the annual inflation rate.

This disappointing performance is attributed to market saturation for standard lottery products like the lotto, instant, and daily numbers games offered in Connecticut as well as to less favorable market conditions. Gaming experts point out that mature lotteries, like Connecticut's, have to work harder just to hold on to sales; increases are more difficult to attain, particularly in an economic recession. Over the past several years, significant sales growth has occurred only in states with newly authorized lotteries or in states that have introduced new products like video lottery games or high payout keno.

Figure 12. Growth in Lottery Sales  
FY 82 - FY 92



Source of Data: DSR

It is clear that the legalized gaming market is more complex and competitive than when the Connecticut lottery was established. In the early 1970s, only a handful of states had authorized lottery games and casino gambling existed only in Nevada. Now, 35 states run lotteries that incorporate a wide variety of lotto, instant, and daily numbers games and, in several cases, video lottery terminals offering casino-style games. Casinos, including those run by Indian tribes, operate in 11 states at present. All states surrounding Connecticut run lotteries. Since February 1992, casino games have been available in Connecticut at the Mashantucket Pequot Indian casino and video slot machines have been operating in Rhode Island since September 1992.

Industry analysts note that for lotteries, like any business competing for discretionary dollars, good product marketing is critical. Effective advertising and market research along with the flexibility to experiment with products and sales techniques are key to the success of lotteries in the 1990s. As pointed out in Christiansen/Cummings Associates report, lotteries are businesses that require a strategy of profit maximization rather than the cost control policies applicable to a bureaucratic state agency.

The program review committee believes the state lottery's current structure constrains the entrepreneurial approach needed to achieve its goal of maximizing revenues for the state. A state agency subject to bureaucratic controls over operating expenses, personnel, and purchasing is ill-equipped to meet the market challenges facing lotteries in the 1990s.

For example, at a time when it is attempting to revitalize sales by marketing new games such as cash lotto, advertising resources have been reduced. The division's budget for all lottery expenses except prizes and agent commissions is controlled through the appropriations process. As part of general state cost cutting policies, the division's budget for lottery advertising has declined by nearly two-thirds over the past five years. In FY 92, lottery advertising expenditures of only 0.4 percent of sales were at the lowest rate in the country according to Christiansen/Cummings Associates and well below the national average of 1.7 percent.

The committee believes as an entrepreneurial enterprise, the lottery would have a much different relationship with its sales force -- the lottery agents. At present, lottery agents are selected on a volunteer basis; no efforts are made to identify and recruit successful retailers as lottery outlets. There is no charge for being a lottery agent despite the fact that many merchants view ticket sales as a valuable draw for their businesses. The current commission structure provides no reward to successful agents; all agents receive five percent of sales regardless of their performance. Incentive programs have been recommended by consultants but the division has yet to act. As a state agency, it is difficult to justify financial incentives that would result in increased appropriations to agents in troublesome economic times even though it might be a net revenue gain.

Performance standards for lottery agents in terms of minimum sales were only recently established. As lottery agents are licensed, enforcement of performance standards, like minimum sales, requires an administrative hearing. This is a costly procedure to the agency compared to the negotiation of business contracts as would be done in the private sector.

The division's licensing process for lottery agents also typifies another difference between a governmental and a business approach. The current licensing process involves a criminal background check of potential agents but not a credit check. Agent licenses are rarely denied for any criminal record yet account delinquency is a significant problem. Based on current calendar year data, the division's collections staff receive roughly 100 referrals concerning delinquent lottery agents per week. Delinquency is the primary reason for taking administrative enforcement actions against agents. In FY 92, there were 41 cases in which lottery agent licenses were revoked; all involved problems in making payments owed to the state.

Recognizing the need to foster a business-like approach, two states recently organized their lotteries as quasi-public entities. Kentucky began operating its lottery as a corporation in 1989 and Louisiana followed this model when it enacted its lottery in 1990. The program review committee believes establishing a quasi-public entity to operate Connecticut's lottery would achieve two important purposes: 1) it would insure the lottery operation is separated from regulation as recommended earlier; and 2) it would provide the flexibility needed to operate the lottery. In the committee's opinion, the operations of the lottery are unique activities for state government and a corporate structure will best enable the lottery to be managed in an entrepreneurial and business-like manner.

Therefore, the committee recommends that all lottery operations be transferred to the Connecticut Lottery Corporation, a quasi-public agency based on Connecticut General Statute section 1-120 through 1-125. The Corporation shall be a wholly owned, non-stock, non-appropriated government corporation.

The Connecticut Lottery Corporation shall be governed by a board of seven directors. The membership shall include the commissioner of the Department of Revenue Services, the Treasurer of the State of Connecticut or his designee, a member of the gaming control commission appointed by the governor, and four members from the private sector who have knowledge and experience in the fields of business, finance, and marketing, to be appointed by the governor. The terms of the four private sector members shall be coterminous with the governor.

There shall be a director of the Connecticut Lottery Corporation appointed by the board of directors who shall report directly to the board.

The powers of the Connecticut Lottery Corporation shall be vested in and exercised by a board of directors. The board of directors may delegate to three or more board members, at least one of whom shall be a non-state employee, such powers and duties that the full board of directors may deem proper. The board can create any advisory committee it deems necessary to provide assistance.

The Connecticut Lottery Corporation's board of directors shall adopt written procedures for:

- an annual budget and a plan of operations that, at a minimum, requires the board's approval before they become effective;
- hiring, dismissing, promoting, and compensating staff, and such procedures and policies shall require board approval before a position can be created or a vacancy filled;
- acquiring real and personal property and personal services, and such procedures shall, at a minimum, require the board to approve all expenditures in excess of \$5,000;
- obtaining professional services, such as financial advisors, legal counsel, and auditors, and at a minimum such procedures shall require the corporation to solicit proposals at least every three years for each service it uses; and
- using surplus funds.

**The purpose of the Connecticut Lottery Corporation shall be to conduct and administer lottery games that will result in the maximization of revenues to the State of Connecticut while at the same time provide entertainment to the citizens. The corporation's duty will be to provide for the effective operation of lottery games, which insures the integrity of the lottery and maintains the dignity of the state and the general welfare of its citizens. To carry out its statutory authority and obligations, the corporation shall have the power:**

- **to adopt an official seal;**
- **to sue and be sued, plead and be impleaded;**
- **to charge and collect fees for its services and products;**
- **to receive and accept aid or contributions including money, property, labor, and other things of value from any source;**
- **to conduct quarterly progress reviews;**
- **to develop a standard policy and procedures manual;**
- **to review and reconfirm purchasing practices;**
- **to make and enter into all contracts and agreements necessary or incidental to the performance of its duties and execution of its powers under its enabling legislation -- including such professional services as financial consultants and technical specialists as the board deems necessary;**
- **to invest any funds not needed for immediate use or disbursement -- including reserve funds -- in obligations issued or guaranteed by the United States of America or State of Connecticut and in other obligations which are legal investments for savings banks in this state;**
- **to employ such staff as it deems necessary and fix their qualifications, duties, and compensation;**
- **to borrow money to the extent permitted by statute;**
- **to procure insurance against any loss in connection with its property and other assets in such amounts and from such insurers as it deems desirable;**
- **to account for and audit funds of the corporation; and**

- to establish and adopt regular procedures for exercising its power under its enabling legislation not in conflict with existing statutes.

The Connecticut Lottery Corporation shall be specifically responsible for the operation of lottery games as follows:

- ◆ the types of games to conducted;
- ◆ the sale price of tickets;
- ◆ the number and amount of prizes;
- ◆ the method and location of validating tickets;
- ◆ the frequency and method of conducting public drawings;
- ◆ the selection of and compensation to lottery retailers; and
- ◆ any other matters necessary or desirable for the efficient and effective operation of the lottery or the convenience of the public.

All lottery proceeds shall be deposited from a special lottery fund, which shall be used to operate the corporation, the lottery games, and provide prizes to winners. Excess funds shall be deposited to the general fund on a quarterly basis.

The Connecticut Lottery Corporation will be required, pursuant to Connecticut General Statute section 1-122, to annually contract with any person, firm, or corporation for a compliance audit of its activities for the fiscal year. The audit will determine the corporation's compliance with its regulations concerning affirmative action, personnel practices, the purchase of goods and services, the use of surplus funds, and distribution of loans, grants, and other financial assistance. The board of directors will submit the audit report to the governor, the auditors of public accounts, the Gaming Control Commission, and the joint standing committee of the general assembly having cognizance of matters relating to gaming and revenue.

The Gaming Control Commission shall be responsible for insuring the integrity of all lottery games.

The auditors of public accounts will be responsible for auditing the Connecticut Lottery Corporation as required by Section 2-90(c) of the Connecticut General Statutes.

This recommendation would achieve the policy goal separating regulatory authority from business practices. The Gaming Control Commission would be responsible for regulating, and the Connecticut Lottery Corporation would be responsible for providing, games to betting public.

The committee believes a quasi-public lottery organization is better equipped than a state agency to meet the challenges of the increasingly competitive environment of the gaming industry.

### **Problem Gambling**

Through its regulatory role, government is responsible for minimizing the social risks associated with gambling. Of serious concern, particularly in states that have legalized, and thus promote gaming, is the issue of problem and pathological gamblers--individuals who cannot control their gambling and suffer financial, emotional, social, and sometimes criminal problems as a result.

As experts note, research on problem and pathological gambling is in a preliminary phase. Pathological gambling has been recognized as a mental illness by the American Psychiatric Association only since 1980. Methods for determining the extent of the problem are still evolving and only a handful of states have conducted prevalence studies. About a dozen states including Connecticut fund programs that conduct research and public education and, in some cases, provide treatment services for compulsive gambling. Existing efforts, however, are on a small scale and model programs have yet to be developed.

The Division of Special Revenue has commissioned studies of problem gambling in Connecticut, primarily to determine prevalence, in response to a statutory mandate to study the effect of legalized gambling on citizens at least every five years. The state's most recent compulsive gambling report, issued in January 1992, was prepared by Dr. Rachel Volberg as part of the Christiansen and Cummings study. Dr. Volberg's research showed that 6.3 percent of Connecticut adults are problem or pathological gamblers. For reasons researchers were unable to explain, Connecticut's rate is higher than that in other states where comparable data are available (i.e., Maryland, 3.9 percent, Massachusetts, 4.4 percent, New Jersey, 4.2 percent, and New York, 4.2 percent).

A compulsive gambling treatment program funded by a special tax on gaming operators has been operating in Connecticut since 1982. However, the committee found that only one segment of the legal gaming industry is required to finance prevention, treatment, and rehabilitation programs for chronic gamblers. By law, each dog racing and jai alai licensee must pay \$135 per performance up to a total of \$45,000 per calendar year in problem gambling fees.

While it appears the fee was also intended to apply to OTB simulcasting, existing statutory language limits it to the now defunct teletrack facility in New Haven.<sup>18</sup> Neither of the OTB teletheaters now in operation (nor any future simulcast facilities) are required to contribute. In addition, none of the more than \$500,000,000 in lottery sales each year is

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<sup>18</sup>Under current statutes only the totalizator vendor for teletrack, the New Haven OTB simulcast facility that closed in March 1992, is subject to a compulsive gambling fee of \$25 per performance.

targeted for the problem gambling program. The committee found that with the present fee structure, compulsive gambling funding could total, at most, \$180,000 regardless of the volume of legal gaming in the state or the extent of problem gambling.

Existing fees have supported the small compulsive gambling treatment program formerly administered by the Department of Mental Health but overseen by the Connecticut Alcohol and Drug Abuse Commission (CADAC) since July 1992. Over its 10 years of operation, the program's annual budget has averaged about \$158,000 per year. Each year, roughly 40 clients are served. At present, there is one staff person, down from a peak in the 1980s of a full-time coordinator, 3 professional consultants (on contract basis), a part-time specialist and a secretary. According to the CADAC executive director, plans for the agency's approach to compulsive gambling in the future are being developed at this time.

Whatever approach is taken by CADAC, it is clear to the program review committee that state efforts as currently funded can have only a minimal impact on problem gambling. Given Connecticut's prevalence rate, (6.3% or about 160,000 adults), the state's program has the capacity to serve about 1 of every 4,000 potential problem and pathological gamblers in the state. The state's present funding commitment to compulsive gambling treatment is equal to less than one-third of its proceeds (net profit) from legalized gaming for one day during FY 92.

The committee believes existing efforts to finance problem gambling prevention, treatment, and rehabilitation are inadequate in light of the state's estimated number of problem gamblers. The present fee structure also unfairly places responsibility for all program costs on just one aspect of legal gaming--jai alai and dog racing.

**Therefore, the committee recommends that existing statutes (C.G.S. Section 17a-477, as amended by Public Act 92-216) be amended to require that a fee equivalent to .05 percent of handle be applied to all legal gaming operations in the state.**

The committee believes all forms of gaming share responsibility for compulsive gambling problems and all, therefore, should contribute to prevention, treatment, and rehabilitation programs. Based on FY 92 data, the recommended change in compulsive gambling fees will significantly increase funding available for prevention, treatment, and rehabilitation. At the rate of .05 percent, over \$500,000 would have been collected last fiscal year. Setting the fee as a percent of handle also permits resources for problem gambling to rise whenever gambling, in terms of amount wagered, increases.

There is little guidance from academic research or other states on what level of funding is appropriate for compulsive gambling programs. Massachusetts, which has a similar economy and mix of legal gaming (along with a lower problem gambling prevalence rate), dedicates \$500,000 from its lottery proceeds for compulsive gambling services. In the opinion of the committee, the recommended amount should be sufficient to improve and expand existing services. Program resources and expenditures would continued to be monitored and evaluated

by the General Assembly through the appropriations process. Any need to adjust the statutory rate, to either increase or reduce funding, could be determined by the legislature as well.

With increased funding, however, comes an even greater need for information about service needs and how compulsive gambling treatment funds are used. It became apparent during the program review committee study that no one within state government is monitoring prevalence, treatment needs, trends, or even the types and amount of services currently provided. Other than its funding level, little information about the state's compulsive gambling program is collected at the Division of Special Revenue. Data on admissions and some basic demographic information have been provided at various times. However, for the past two fiscal years, the division has received no information about the program.

Furthermore, no information on compulsive gambling is reported regularly to the Gaming Policy Board. Findings from the most recent consultant report concerning problem gambling in Connecticut were never formally presented to board members. Based on meetings attended and board minutes reviewed by the program review committee, issues related to problem gambling have not been considered in decision-making for at least the past two years.

More effort is needed to both collect and consider data on compulsive gambling in Connecticut. Better communication between the entities responsible for legalized gaming policy and regulation and the agency responsible for preventing and treating problem gambling is an obvious first step.

**The program review committee recommends that the Connecticut Alcohol and Drug Abuse Commission be required to report annually to the Gaming Control Commission on the activities of the compulsive gambler treatment program it administers. At a minimum, the commission should receive information on requests for services, number of admissions, client demographics, and source of problem (e.g., uncontrolled behavior related to lottery, racing, casino games, etc.).**

This recommendation would insure the commission formally considers problem gambling issues at least once a year. The required report would promote accountability for the compulsive gambling treatment program by allowing outside review of activity and outcome data. Such information could also help regulators and policy-makers gain a better understanding of the impact of state decisions about legalized gaming on problem gamblers.



APPENDICES

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**APPENDIX A**  
**Legalized Gambling: 50 State (and D.C.) Comparison**  
**Status as of mid-1992**

	LOTTERY					PARIMUTUEL/ OFF TRACK*				CASINO GAMES AND OTHER					
	L o t t o	I n s t a n t	N u m b e r s	K e n o	V L T	D o g	H o r s e	O f f T r a c k	J a i A l a i	C a s i n o s	S l o t s	S p o r t s	C a r d r o o m s	B i n g o	P u l l T a b s
ALABAMA						•	•	•						•	
ALASKA		•												•	•
ARIZONA	•	•				•	•	•						•	•
ARKANSAS						•	•	•							
CALIFORNIA	•	•	•				•	•					•	•	•
COLORADO	•	•				•	•	•		•	○		○	•	
CONNECTICUT	•	•	•			•	○	•	•	•			•	•	•
DELAWARE	•	•	•				•	•						•	•
FLORIDA	•	•	•			•	•	•	•					•	
GEORGIA														•	
HAWAII															
IDAHO	•	•	•			•	•	•						•	
ILLINOIS	•	•	•		■		•	•		•			○	•	•
INDIANA	•	•	•				○							•	•
IOWA	•	•			○	•	•	•		•			•	•	•
KANSAS	•	•		•		•	•							•	•
KENTUCKY	•	•	•				•	•						•	•
LOUISIANA	○	○					•	•		○			•	•	•
MAINE	•	•	•				•	•						•	•

APPENDIX A  
Legalized Gambling: 50 State (and D.C.) Comparison  
Status as of mid-1992

	LOTTERY					PARIMUTUEL/ OFF TRACK*				CASINO GAMES AND OTHER					
	L o t t o	I n s t a n t	N u m b e r s	K e n o	V L T	D o g	H o r s e	O f f T r a c k	J a i A l a i	C a s i n o s	S l o t s	S p o r t s	C a r d r o o m s	B i n g o	P u l l T a b s
MARYLAND	•	•	•				•	•			•		•	•	•
MASSACHUSETTS	•	•	•			•	◼	•						•	•
MICHIGAN	•	•	•	•			•	•		•			•	•	•
MINNESOTA	•	•					•	•		•	•		•	•	•
MISSISSIPPI										○	○		○	•	•
MISSOURI	•	•	•				•	•						•	•
MONTANA	•	•			•		•	•			•	•	•	•	
NEBRASKA				•	◼		•	•						•	•
NEVADA				•		◼	•	•	○	•	•	•	•	•	
NEW HAMPSHIRE	•	•	•			•	•	•						•	•
NEW JERSEY	•	•	•				•	•		•	•			•	
NEW MEXICO							•	•						•	•
NEW YORK	•	•	•	•			•	•						•	•
NORTH CAROLINA														•	
NORTH DAKOTA							•	•		•		•	•	•	•
OHIO	•	•	•				•	•						•	•
OKLAHOMA							•	•						•	
OREGON	•	•	•	○	○	•	•	•				•	•	•	•
PENNSYLVANIA	•	•	•	•			•	•						•	

**APPENDIX A**  
**Legalized Gambling: 50 State (and D.C.) Comparison**  
**Status as of mid-1992**

	LOTTERY					PARIMUTUEL/ OFF TRACK*				CASINO GAMES AND OTHER					
	L o t t o	I n s t a n t	N u m b e r s	K e n o	V L T	D o g	H o r s e	O f f t r a c k	J a i A l a i s	C a s i n o s	S l o t s	S p o r t s	C a r d r o o m s	B i n g o	P u l l T a b s
RHODE ISLAND	•	•	•		◆	•	◼	•	•					•	•
SOUTH CAROLINA														•	
SOUTH DAKOTA	•	•			•	•	•	•		•			•	•	•
TENNESSEE							○	•						◼	
TEXAS	○	•				•	•	○						•	•
UTAH															
VERMONT	•	•	•			•	•							•	•
VIRGINIA	•	•	•				○							•	•
WASHINGTON	•	•	•		•		•						•	•	•
WASH. D.C.	•	•	•											•	•
WEST VIRGINIA	•	•	•			•	•	•						•	•
WISCONSIN	•	•				•	○			•			•	•	•
WYOMING							•	•						•	•

**KEY:**

- = legal and operative
- = legal but not yet operative
- ◼ = legal but no longer operative
- ◆ = VLTs became operative in Rhode Island in September 1992.

\* Includes both intrastate and interstate intertrack betting as well as off-track betting

Source of Data: *Gaming and Wagering Business Magazine*, Sept. 15 - Oct. 14, 1992 issue.



## **APPENDIX B**

### **AGENCY RESPONSE**







# STATE OF CONNECTICUT

## DEPARTMENT OF REVENUE SERVICES DIVISION OF SPECIAL REVENUE

RUSSELL ROAD, P.O. BOX 11424  
NEWINGTON, CONNECTICUT 06111

January 29, 1993

Representative Jonathan Pelto  
and Senator Judith G. Freedman  
Co-Chairs, Program Review and Investigations  
Room 506, State Capitol  
Hartford, CT 06106

Dear Senator Freedman and Representative Pelto:

I appreciate your affording the Division of Special Revenue an opportunity to comment on the Program Review and Investigation Committee's final report.

If either of you or any members of the Committee have any comments or questions concerning the attached, please do not hesitate to contact me at 566-2756.

I look forward to working with you over the course of the 1993 legislative session.

Respectfully yours,

A handwritten signature in cursive script that reads "Robert W. Werner".

Robert W. Werner  
Executive Director

## **Introduction**

The Division of Special Revenue welcomes the opportunity to offer comments on the Program Review and Investigation Committee's report. The report offers a plan for creating two distinct agencies by separating the regulation and the operation of legalized gambling in the State. It also suggests that as a "quasi-public" authority the lottery would become more successful. Moreover, the report recommends that off-track betting be privatized and that certain statutory restrictions be eliminated.

The Division believes that its present organizational structure provides the best approach to serving the State's interests. This belief arises out of thirteen years of successful experience operating and regulating gambling in Connecticut. The Division is, however, in basic agreement with regard to the recommendations pertaining to off-track betting. The presentation of the Division's comments and observations will follow chronologically the main topics of the Committee's report.

## **Separating Regulatory Functions and Operations**

The Division respectfully disagrees with the assertion that there is an "inherent" conflict between the regulatory and the operating responsibilities of the Division of Special Revenue. The philosophy that has guided the Division of Special Revenue over more than a decade is that vigilance and the appropriate organization and assignment of functions and duties will eliminate the potential risk of problems arising from the Division's dual role as operator and regulator. Based on the Division's history, this supposed conflict has proved to be academic rather than actual. In fact, the record shows that the combination of these functions has enhanced the efficiencies and the integrity of the Division's regulatory and operational responsibilities.

The Division is currently organized in a manner that prevents conflicts of interest. The Division's accounting and auditing functions are kept entirely separate from all operational functions in order to ensure integrity and objectivity. Likewise, the Security Unit, which polices both the lottery and OTB, reports directly to the Executive Director. Finally, never has the fact that the Division operates the lottery or OTB given rise to an actual or perceived conflict with regard to regulation of the pari-mutuels. The Division has insured the integrity of all legalized gaming in the state.

During Fiscal Year 1992, as in past years, the Division balanced its many operational and regulatory responsibilities. Specifically, it:

- raised revenues of \$1,036,365,000 and transferred \$253,721,000 to the General Fund
- conducted 471 lottery drawings and presented 611 days of racing performances at off-track betting facilities
- imposed 139 fines totalling \$13,737 for violations of pari-mutuel rules
- presided over 1,283 performances at the four pari-mutuel facilities to assure compliance with division regulations; collected 27,090 urine specimens for testing to insure the integrity of greyhound racing
- issued licenses to 2,094 charitable organizations to allow them to conduct various forms of gaming
- issued licenses to 3,418 individuals who work in some aspect of charitable gaming
- issued 6,551 licenses to individuals who work in the pari-mutuel facilities, or in related business, or who sell lottery tickets
- conducted 260 security investigations, both administrative and criminal, pertaining to legalized gaming operations.

Support for the Division's position can be found in the 1990 final report of the Commission to Study the Management of State Government (the "Thomas Commission"). This study, which was also commissioned by the General Assembly, had a strikingly similar mission to the stated objectives of the Program Review study. The Thomas Commission was charged with the responsibility of identifying ways to improve the delivery and efficiency of services and programs, increasing revenue and finding ways to reduce the level of agency spending. After an intense period of study, the Commission issued a report containing very different conclusions and recommendations than those contained in the Program Review report. On the whole, it found the Division of Special Revenue to be well-managed.<sup>1</sup> The first major recommendation of the Thomas Commission did not propose the division of agency activities, but rather it recommended elevating the agency to department status, thereby removing it from its current position within the Department of Revenue Services "for administrative purposes only."<sup>2</sup>

## Lottery Operations

The Program Review study recommends that the lottery be operated as a "quasi-public governmental agency." The arguments advanced in support of this recommendation rest primarily on the notion that there will be a substantial benefit to separating regulation from operations and that a quasi-governmental organization will be better able to compete in the marketplace.

Only two states operate under the structure of a quasi-public authority. The Program Review Committee report offers these states as models for Connecticut despite the fact that neither state has had a long or comparatively successful track record. The Louisiana Lottery has operated for less than a year and, therefore, there are no statistics available concerning its success or lack of success. The Kentucky Lottery has only two years of operating experience as a public authority, and its success is questionable.

Kentucky's record shows that for Fiscal Year 1991, per capita lottery sales were \$57, which earned it a rank of twenty-fourth out of thirty-three lottery jurisdictions nationwide. By comparison, Connecticut's per capita lottery sales were \$161, which ranks the state fifth.<sup>3</sup> In order to achieve these sales results, Connecticut spent \$4.5 million dollars on advertising -- one million dollars less than Kentucky spent that year for a significantly lower per capita sales level.<sup>4</sup> For Fiscal Year 1991 Kentucky's operating expenses were 11.4% of sales, contrasted with Connecticut's expense ratio of 4.7%.<sup>5</sup> This ranks Connecticut fifth in terms of its efficiency, more than two and a half times more efficient than Kentucky. In the twenty years that Connecticut's lottery has been operated and regulated by the Division of Special Revenue, it has generated \$5.2 billion in total sales and has transferred more than \$2.2 billion to the General Fund.

It is very likely that the establishment of a separate lottery organization would adversely effect the lottery's expense-to-sales ratio due to the duplication of functions that would result from such a separation. Examples of such duplication would be in the areas of personnel/payroll, purchasing, budgeting and data processing. Moreover, without the constraints of state administration, it is likely upper-management salaries would be inflated. None of these changes alone, or in combination, would guarantee an increase in lottery sales. It should also be noted that separating the lottery would make its regulation more difficult. Rather than having immediate access to and control over the lottery's accounting, marketing and testing functions, the Division would have to depend on external auditing and investigation. The loss of this regulatory control can only be justified by significant operational enhancements.

The Program Review Committee's report also assumes that the Christiansen/Cummings Associates gaming study, completed in 1992,

"strongly recommended" separating the lottery operations from the rest of the Division of Special Revenue programs. In fact, the Christiansen/Cummings report recommended maintaining a gaming umbrella organization with the lottery as a part of it. As the report stated:

[W]e recommend that the functions associated with the Connecticut Lottery be separated from the other functions of the Division. This could be accomplished either by a complete separation, into an organizationally distinct "Connecticut Lottery", parallel to the practice in other States, or more simply by collecting those functions within a "Lottery Subdivision" of the Division. We believe the latter option is preferable for two reasons."<sup>6</sup>

One of the reasons cited by Christiansen/Cummings was the "unique strength" gained by placing all forms of gaming under the oversight of the Gaming Policy Board because it is charged with evaluating the broad public policy for the state. As a result of shared administrative functions, it was also observed that the State, the Division and all of the individual gaming programs benefit from economies of scale. Additionally, the Planning and Research staff perform market research and provide internal consulting and planning for all Special Revenue programs.

It is also significant that many of the operating problems identified by Christiansen/Cummings Associates have been addressed by the Division since the publication of that report. The Division has begun implementation of an automated instant ticket validation system for the lottery which has simplified and improved the accounting and distribution process for instant ticket games. The Division has also obtained verbal approval from the Office of Information & Technology for a detailed plan to upgrade its management information system in order to more effectively support the information needs of the lottery and other Division programs. These were accomplished through management initiatives rather than through a costly organizational restructuring.

### **Agency Restructuring**

The Program Review study recommends a consolidation of the Planning and Research, Security, Personnel and Payroll Units within the Administration Unit. This grouping of functions would weaken the effectiveness of the work performed by each of these specialized units.

The Planning and Research Unit provides an important staff function to the Office of the Executive Director. A 1979 study, which called for a reorganization of the Division, recognized the importance of this function's independence. Subsequent studies have also

recognized the importance of this unit. The activities of the Planning and Research Unit focus on policy development, implementation and enforcement. The first two of these responsibilities are addressed through the coordination of long and short range agency planning efforts; the study of gaming policy; review and evaluation of legislative matters, including drafting of legislation and regulations; the coordination of major research projects; the analysis of gaming performance and trends in gaming; and conducting of policy studies and operational improvement efforts. Thirdly, the Planning and Research Unit's coordination and conduct of the administrative hearing process is a significant regulatory and policy function of the agency. All of these diverse activities require the focused direction of a high level manager, one who reports directly to the Executive Director. It is important to maintain the influence and effectiveness of this unit.

The Program Review report also appears to underestimate the Security Unit's role within the agency. Security is a complex function that is integrated into the regulatory and operational aspects of the Division. The regulatory mission of the Division is served by preserving the integrity and safety of gaming, free from any activity that compromises it or allows for irregularities in behavior or business practice. Security staff play a key role in the licensing process by coordinating background checks on applicants with the State Police. Security personnel also testify at administrative hearings in cases involving licensing denials, revocations or suspensions. They perform overt and covert surveillance of all gaming activities in order to prevent and detect abuses of agency regulations and criminal activity. Security's investigations focus on subjects ranging from the behavior of employees of the Division, to the patrons of a Jai Alai fronton, to lottery agents. Due to the highly specialized and sensitive nature of this work, the Security Unit should remain a separate function reporting to the Executive Director.

The committee proposal would also assign the tax collection responsibilities that are currently performed by the Division to the Department of Revenue Services. For purposes of maintaining optimum efficiency, accountability and control, the three closely related financial functions of accounting, auditing and revenue collection should remain within a single agency.

Finally, the Program Review report observed that there are three reasons for regulating gambling, that is to insure integrity of the games, to establish marketplace rules, and to maximize revenue to the state.<sup>7</sup> The third reason enunciated, "maximizing revenues," is actually not a regulatory objective. It is an objective associated with the operation of legalized gaming.

## **Licensing Process**

The Division shares the Committee's concern for maintaining strong regulatory vigilance over gaming in the state. In order to be effective in this role, the Division must be given the tools needed to perform the job. Licensing is one of the most important means that the Division currently possesses to ensure regulatory integrity.

The Committee report proposes narrowing the universe of those subject to the Division's licensing requirements, a move which the Division believes would weaken its regulatory effectiveness. Licensing, like other aspects of gaming regulation, provides the state and the public with assurances that standards will be maintained and integrity will be upheld. Without licensing authority, the state would lose a critical basis for its enforcement.

Additionally, another objective of regulation is to send a message to the public, as well as to those who might consider abusing those regulations, that the state is assuring both the public's health and safety at gaming facilities and that it is also assuring that the gaming activity itself will be free of irregularities. The public's confidence would be undermined if the state did not fully and completely license all individuals and businesses associated with the gaming industry. Some examples may help to illustrate this point:

- A technician for a totalizator company is suspected of tampering with the computer, which in turn affects the amount of prizes that are paid to winners.
- A small business that sells instant lottery tickets is suspected of compromising instant tickets.
- A pari-mutuel cashier pockets wagers rather than placing them for a bettor.

The public's perception of the integrity of gaming is essential to its viability, and it is therefore a significant consideration in planning the state's regulatory effort. A great deal of time and effort goes into creating both the appearance and the fact of integrity. The Division believes the licensing process should not be narrowed in scope.

## **Off-Track Betting Operations**

The Committee's report suggests that consultant recommendations to pursue privatization have been ignored. In fact, neither the Thomas Commission nor the Christiansen/Cummings report recommended privatization of OTB in absolute terms.

In 1990, at the time of the Thomas Commission study, the Division was evaluating options for OTB's future, including the possibility of privatization. The Thomas Commission report recommended that:

...DSR continue with its Request for Information and evaluate the alternatives offered by potential vendors. The responses should provide DSR with information necessary to determine the potential disposition of OTB and future organization structure.<sup>8</sup>

In 1992, Christiansen/Cummings made the following recommendations:

The DOSR has already initiated a RFP process to solicit proposals for the enhancement of OTB under three alternatives: private, public/private partnership or direct State operation. We recommend that this process continue...<sup>9</sup>

Christiansen/Cummings also cautioned against moving too quickly in the direction of privatization, pointing out that alternative models should be considered along the way. They observed that the sale of the system is a "negotiating process," and, in order to effectively negotiate privatization, the State must demonstrate that it has alternatives. Christiansen/Cummings advised that:

Above all, a "distress sale" approach must be avoided.<sup>10</sup>

The Division did, in fact, give consideration to privatization throughout the process of evaluating the various proposals submitted. The contract negotiated with International Totalizator Services, Inc. recognized the possibility of an eventual change in statutes that would bring about private ownership of the system and a transfer of the contract to a new, private owner. The decision to select ITS as a vendor for OTB was consistent with the advice provided by Christiansen/Cummings, since the plans included improvements to the system.

Since that time, the Division has continued to move forward with plans for the privatization of OTB. The Division believes, however, that the laws that govern OTB need to be revised in order to permit a privately operated OTB to function effectively. Specifically, the Division respectfully recommends that the following statutory provisions be eliminated:

- requirements for bench seating
- restrictions concerning permitting the use of monitors and restaurants in all OTB branches
- the 35-mile zone of protection around Windsor Locks Teletheather



### **Conclusion**

The Division of Special Revenue has functioned effectively for thirteen years, maintaining the integrity of legalized gambling while maximizing revenues. As the Christiansen/Cummings study noted, the current structure should be maintained in the interest of continued efficiency and cost effectiveness, and because it provides the optimum framework for continuing the strong, effective regulation of all forms of gaming.

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### Endnotes

1. KMPG Peat Marwick, Certified Public Accountants, Commission to Study the Management of State Government, Final Report of Department of Revenue Services, Division of Revenue Services, Department of Economic Development, November 21, 1990, page 106.
2. Ibid.
3. La Fleur, Terri, 1992 Compendium of Lottery Statistics, TLF Publications, Inc., Boyds, Md., 1992, page 25.
4. Ibid, page 79.
5. Ibid, page 34.
6. Christiansen/Cummings Associates, Inc., Legal Gambling in Connecticut: Assessment of Current Status and Options for the Future, January 13, 1992, page 332.
7. Legislative Program Review and Investigations Committee, Staff Findings and Recommendations "Regulation and Operation of Legalized Gaming in Connecticut", December 15, 1992, page 27.
8. KMPG Peat Marwick at page 120.
9. Op. Cit., Christiansen/Cummings, page xi.
10. Ibid, page 528.